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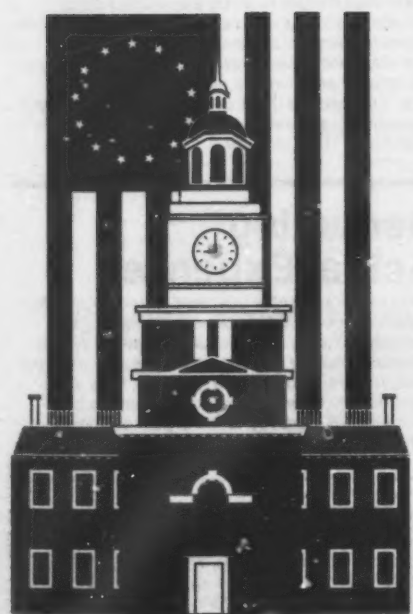


Department of the Treasury
Internal Revenue Service
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Business Use of a Car

For use in preparing
1990 Returns



Important Changes for 1990

Standard mileage rate. The standard mileage rate for 1990 is 26 cents per mile for all business miles. You are not subject to the 15,000 mile annual limit which applied in prior years. See *Standard Mileage Rate*.

Limitations on business vehicles. The total section 179 deduction and depreciation you can take on a vehicle you use in your business and first place in service in 1990 is \$2,660. Your depreciation cannot exceed \$4,200 for the second year of recovery, \$2,550 for the third year of recovery, and \$1,475 for each later tax year. See *Depreciation Limits*.

Important Reminders

Employee business expenses now claimed as itemized deductions only. You must itemize your deductions on Schedule A (Form 1040) in order to deduct any employee business expenses. These expenses are subject to a 2% of adjusted gross income limit.

If your employee business expenses are **reimbursed under an accountable plan**, the reimbursement will not be included in your income on your Form W-2 so you will not need to deduct the expenses. See *Accountable Plans*, later.

Nonaccountable plans. Your employee business expenses are treated as if they are **unreimbursed** if your employer uses a nonaccountable plan to reimburse you for the expense. Your employer is required to include the reimbursement in your income on Form W-2 and you can deduct the expenses as itemized deductions subject to the 2% limit. See *Nonaccountable Plans*, later.

Introduction

This publication explains the expenses you can deduct on your income tax return for the business use of your car. These expenses are generally known as transportation expenses. Transportation expenses also include the cost of travel by air, rail, bus, taxi, etc., but not the cost of meals and lodging or travel while away from home.

You are away from home if your job duties require that you are absent from your main place of work for a period long enough to require you to get sleep or rest before returning.

Car expenses that are deductible include those expenses necessary to drive and maintain a car that you use to go from one workplace to another. They do not include the cost of driving from your home to your regular workplace (see *Commuting Expenses*, discussed later). Car expenses you have while traveling away from home, though not deductible as transportation expenses, can sometimes be deducted as travel expenses. Publication 463, *Travel, Entertainment, and Gift Expenses*, discusses travel expenses and some special rules that may apply. However, you generally figure your deduction for car expenses the same whether the expense is considered travel or transportation.

This publication is for use by employees; however, the items discussed in this publication also apply to employers and self-employed persons. Some topics covered in this publication are:

- Standard mileage rate
- Depreciation
- Section 179 deduction
- Business use of a leased car
- Vehicle provided by employer
- Recordkeeping

Car defined. The word car, as used in this publication, means any four-wheeled vehicle that is manufactured primarily for use on public streets, roads, and highways. It must have an unloaded

gross vehicle weight of 6,000 pounds or less or in the case of a truck or van, a gross vehicle weight of 6,000 pounds or less. A car includes any part, component, or other item that is physically attached to it or is traditionally included in the purchase price.

A car does not include:

- 1) An ambulance, hearse, or combination ambulance-hearse used directly in a business,
- 2) A vehicle used directly in the business of transporting persons or property for compensation or hire, and
- 3) Certain commuter highway vehicles placed in service by employers before 1986.

Car expense records. You must keep records to show when you started using your car for business and the cost or other basis of the car. Your records must also show how many business miles and total miles you drove your car during the year. If you use actual expenses, you must keep records of the costs of operating the car, such as car insurance, interest, taxes, licenses, maintenance, repairs, depreciation, gas, and oil. If you lease a car, you must keep records of this cost. For more information, see *Recordkeeping*, later.

Other publications. Here are some free publications that you may find helpful if you have other employee business expenses or if you use your vehicle for charitable or medical purposes.

Publication 463, *Travel, Entertainment, and Gift Expenses*

Publication 502, *Medical and Dental Expenses*

Publication 526, *Charitable Contributions*

If you receive a fringe benefit, other than an employer-provided vehicle, you may want to get Publication 525, *Taxable and Nontaxable Income*. Employers may find the following publications helpful.

Publication 534, *Depreciation*

Publication 535, *Business Expenses*

Free Publications and Forms

If you need information on a subject not covered in this publication, you may check our other free publications. To order publications and forms, call our toll-free telephone number 1-800-TAX-FORM (1-800-829-3676) or write the IRS Forms Distribution Center for your area as shown in the income tax package.

Deductible and Nondeductible Expenses

If you are required to use a car in your business or work, you may be able to deduct car expenses. The deductible items include the costs of:

Gas	Garage rent	Repairs
Oil	Lease fees	Licenses
Tolls	Rental fees	Insurance
Tires	Parking fees	Depreciation

Instead of figuring actual expenses, you may be able to use the standard mileage rate (discussed later).

If you use your car for both business and personal purposes, you must divide your expenses between business and personal use.

Example. You are a sales representative for a clothing firm and drive your car 20,000 miles during the year: 12,000 miles for business and 8,000 miles for personal use. You can claim only 60% (12,000 ÷ 20,000) of the cost of operating your car as a business expense.

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Interest on car loans. For 1990, if you are an employee, you can deduct only 10% of the interest paid on a car loan in 1990. This interest is treated as personal interest and is deductible only if you itemize deductions on Schedule A. Show your car interest expense on line 12a of Schedule A. Do not include interest expense on Form 2106. If you are not an employee, see *Business car expenses*, below.

Taxes on your car. If you are an employee, you can deduct property taxes you paid on your car only if you itemize deductions on Schedule A. You cannot deduct sales tax, even if you use your car 100% for business as an employee. Sales tax is part of your car's basis and may be recovered through depreciation. See *Depreciation*, later. For more information on taxes, see the Form 1040 instructions. If you are not an employee, see *Business car expenses*, below.

Casualty and theft losses. If your car is damaged, destroyed, or stolen, you may be able to deduct part of the loss that is not covered by insurance, whether or not you used your car for business. See Publication 547, *Nonbusiness Disasters, Casualties, and Thefts*, and Chapter 25, *Casualties, Thefts, and Condemnations* in Publication 334, *Tax Guide for Small Business*, for more information.

Business car expenses. If you operate your own trade or business as a sole proprietor, deduct your car expenses on Schedule C, *Profit or Loss From Business*. Do not complete Form 2106. See Publication 535, *Business Expenses*, for information on business expenses not covered in this publication.

Car pools. You cannot deduct the cost of using your car in a nonprofit car pool. Do not include payments from the passengers in your income. These payments are considered reimbursements of your expenses. However, if you are in a car pool for a profit, you must include these payments in income and you can deduct your expenses (using the rules in this publication).

Fines and collateral for traffic violations are not deductible.

Commuting Expenses

You cannot deduct the costs of driving a car between your home and your main or regular place of work. These costs are personal commuting expenses. You cannot deduct commuting expenses no matter how far your home is from your regular place of work. You cannot deduct commuting expenses even if you work during the trip.

Example. You had a telephone installed in your car. You sometimes use that telephone to make business calls while commuting to and from work. Sometimes business associates ride with you to and from work and you have a business discussion in the car. These activities **do not change** the trip from commuting to business. Your commuting expenses are not deductible.

Hauling tools or instruments in your vehicle while commuting to and from work does not make your commuting costs deductible. However, you can deduct additional costs, such as renting a trailer that is towed by your vehicle, for carrying equipment to and from your job.

Advertising display on car. The use of your car to display material that advertises your business does not change personal use to business use. If you use this car for commuting or other personal use, your expenses for such use are not deductible.

Trips from a union hall. If you get your work assignments at a union hall and then go to your place of work, these costs are nondeductible commuting expenses.

Example. You are a banquet waitress who works at several locations in your hometown area. Your union requires you to appear at the union hall to receive your work assignment for the day. Although you need the union to get the job, you are employed where you work, not where the union hall is located. Therefore, you cannot deduct the trips from your union hall to your place of work.

Parking fees paid to park your car at your place of work are nondeductible commuting expenses.

Temporary work location. If you have one or more regular places of business and commute to a temporary work location, you can deduct the expenses of the daily round-trip transportation between your residence and the temporary location. If the temporary work is in the same metropolitan area as your regular place of work, the temporary work must be irregular or short-term (generally a matter of days or weeks). If the temporary work is beyond the general area of your regular place of work, see Publication 463 for more information.

Two places of work. If you work at two places in a day, whether or not for the same employer, you can deduct the expense of getting from one place to the other. However, if for some personal reason you do not go directly from one location to the other, you can deduct only the amount it would have cost you to go directly from the first location to the second. Transportation expenses you have in going between home and a part-time job on a day off from your main job are commuting expenses. You cannot deduct them.

Armed forces reservists. A meeting of an armed forces reserve unit is considered a second place of business if the meeting is held on the same day as your regular job. You can deduct the expense of getting from one place to the other as just discussed. You usually cannot deduct the expense if the meeting is held on a nonwork day for your regular job.

For meetings held on nonworkdays you can deduct your daily transportation expenses only if the location of the meeting is temporary and you either:

- 1) Have one or more regular places of work, or
- 2) Ordinarily work in a particular metropolitan area but not at any specific location and the reserve meeting is held outside that metropolitan area.

You can deduct your expenses for transportation, meals, and lodging if you travel away from home to a Guard or Reserve meeting or camp. Travel away from home generally requires an overnight stay. For more information see *Travel Expenses* in Publication 463, *Travel, Entertainment, and Gift Expenses*.

Standard Mileage Rate

Instead of figuring actual expenses, you can use the standard mileage rate of 26 cents a mile for an unlimited number of business miles. Beginning in 1990, the 15,000 mile annual limit no longer applies. You can use this rate instead of your actual expenses (including depreciation), in figuring the deductible costs of operating a passenger car, including a van, pickup, or panel truck. You can use the standard mileage rate whether or not you are reimbursed and whether or not any reimbursement is more or less than the amount figured using the standard mileage rate. See *How to Report*, later.

Choosing the standard mileage rate. If you want to use the standard mileage rate for a car in any year, you must choose to use it in the first year you place the car in service in your business. In later years, you can use the standard mileage rate or actual expenses. If you do not choose the

standard mileage rate in the first year, you cannot use it for that car in any year.

If you use the standard mileage rate in the first year of business use, you are considered to have made an election not to use the depreciation methods discussed later, since the standard mileage rate allows for depreciation. You also cannot claim the section 179 deduction (discussed later). If you change to the actual cost method in a later year, but before your car is considered fully depreciated, you have to estimate the useful life of the car and use straight line depreciation.

To use the standard mileage rate you must:

- 1) Own the car,
- 2) Not use the car for hire, for example as a taxi, and
- 3) Not operate a fleet of cars using two or more at the same time.

Interest and state and local taxes. If you itemize your deductions on Schedule A, you can deduct part of the interest on car loans and state and local personal property taxes on motor vehicles even if you use the standard mileage rate. See *Deductible and Nondeductible Expenses*, earlier.

Parking fees and tolls. In addition to the standard mileage rate, deduct any parking fees and tolls you have during business use.

If you adequately account to your employer for reimbursements or allowances for the use of your car and your employer does not include the reimbursed amounts in your income, you can deduct only the cost that is more than your reimbursement or allowance. See *Accountable Plans*, later.

Example. You drive your car 14,000 miles in your work. You get \$900 worth of gas from your employer, who has a gas pump for the business. The \$900 is not included on your Form W-2. You decide to use the standard mileage rate to figure your car expenses for 1990. You can deduct \$2,740 figured as follows.

Business miles driven	14,000
Standard mileage rate	× 26
Total expense	\$3,640
Less employer-paid expense	900
Deductible expense	\$2,740

See *How to Report*, later.

Rural mail carriers. If you are a U.S. Postal Service employee who collects or delivers mail on a rural route, you can use a special 39 cents a mile standard mileage rate. You can use this special rate for an unlimited number of miles each year. You **cannot** use this rate if you claimed any depreciation expense under the actual expense method for 1986 or 1989.

Deducting Actual Expenses

If you use your car for business, you may be able to deduct your actual expenses instead of the standard mileage rate, discussed earlier. Actual expenses include such items as gas and oil, insurance, repairs, parking fees and tolls, tires, and depreciation. Claim your actual expenses by completing Form 2106 if you are an employee or Schedule C if you are self-employed.

General Rules

Generally, there are limits on the amounts of section 179 deduction and depreciation you can deduct. Also, special rules apply if you use your car 50% or less in your work or business. These

rules do not apply to qualified nonpersonal use vehicles as discussed later under *Vehicle Provided by Employer*.

Percentage of use. Generally, you must use a car more than 50% for business or work to qualify for the section 179 deduction and recovery (depreciation) deduction. Using your car as an employee is treated as business use only if that use is for the convenience of your employer and required as a condition of your employment.

The use of your car must be required for you to perform your assigned duties properly. Whether this use is required depends on all the facts and circumstances. Your employer does not have to explicitly require that you use your car. However, a mere statement by your employer that the use of your car is required as a condition of employment is not sufficient.

Limits. For cars placed in service after June 18, 1984, the amount you can claim for the depreciation or recovery deduction (including the section 179 deduction) is limited. The chart *Maximum Limits*, below, will help you determine the applicable maximum limits allowed depending on when you placed your car in service. You have to adjust the amounts shown on the chart if you did not use the car exclusively for business.

If you placed your car in service before June 19, 1984, these limits do not apply.

Section 179 Deduction

Generally, the cost of a car, plus sales tax and improvements to the car, is a capital expenditure. You can recover this cost by claiming a depreciation deduction. In other words, you recover the cost over more than one year by deducting part of it each year. Depreciation is discussed later.

The section 179 deduction allows you to elect to treat a portion or all of the cost of a car as an expense rather than as a capital expenditure. As an expense, the section 179 amount is deductible in the year the car is placed in service. For this purpose, "placed in service" means the year when you first use the car for any purpose. The section 179 deduction is available for all qualifying property, including cars. Generally, the section 179 deduction allowed for the total cost of qualifying property is limited to \$10,000 a year. The yearly limit for a car, however, depends on when the car was placed in service and the percentage of business use. In addition, the total amount of your section 179 and depreciation deductions on your car is subject to a yearly limit.

You must use your car **more than 50%** for business or work to elect the section 179 deduction for your car. See *Partial Business Use*, later.

Limitation. The total amount of section 179 and recovery (depreciation) deductions you can claim for a car placed in service after 1988 cannot be more than \$2,660 for the tax year placed in service. The limits for cars placed in service are summarized in the table below.

The limit is reduced if your business use of the car is less than 100%. For example, if you buy and place in service on May 2, 1990, a car that you use 80% for business, your total section 179 deduction and depreciation cannot be more than \$2,128 (80% × \$2,660).

Cost of car. The cost of the car for purposes of the section 179 deduction does not include any amount figured by reference to any other property held by you at any time. For example, if you buy a new car to use in your business, your cost for purposes of the section 179 deduction does not include the adjusted basis of the car you trade in on the new vehicle.

Basis of car. The amount of the section 179 deduction reduces the basis of your car. If you elect the section 179 deduction, you must reduce the basis of your car before you figure your depreciation deduction. Generally, electing a section 179 deduction gives you a larger total deduction (recovery plus section 179) in the first year while not electing it gives you a larger recovery deduction in the subsequent years.

Example. On January 2, 1990, Stella bought a car for \$12,000, including sales tax, to use in her delivery business. She paid \$9,000 cash and received \$3,000 in trade for her old car (also used in her business). The adjusted basis of her old car was \$3,000. At the end of 1990, Stella computed her business use of the new car to be 80%. Her total section 179 expense and first-year depreciation cannot exceed \$2,660.

Stella's basis in the new car is \$3,000 for purposes of section 179. Her basis for depreciation would be \$12,000 if she did not elect section 179. If she elects section 179, the total of her section 179 and depreciation deductions is limited to \$2,128 (\$2,660 first year maximum × 80% business use). If she had not elected section 179, her depreciation deduction, using the MACRS method (discussed later) would be \$1,920 (\$12,000 basis × 80% business use × 40% (double declining balance rate) × one-half year).

When to elect. If you want to take the section 179 deduction, you must make the election in the tax year the car is placed in service. Employees use Form 2106, *Employee Business Expenses*, to

make this election and report the section 179 deduction. All others use Form 4562, *Depreciation and Amortization*. You make the election by taking the deduction on the appropriate form filed with your original tax return. The election cannot be made on an amended tax return filed after the due date (including extensions), and once made, the election can be changed only with the consent of the Internal Revenue Service.

Reduction in business use. To be eligible to claim the section 179 deduction, you must use your car more than 50% for business or work in the year you acquired it. If your business use of the car is 50% or less in a later tax year during the recovery period, you have to include in income in that later year any excess depreciation. Any section 179 deduction claimed on the car is included in calculating the excess depreciation. For information on this calculation, see *Excess depreciation*, later under *Partial Business Use*.

Dispositions. If you dispose of a car on which you had claimed the section 179 deduction, the amount of that deduction is treated as a depreciation deduction for recapture purposes. Any gain on the disposition of the property is treated as ordinary income to the extent of the section 179 deduction and any depreciation you claimed. For information on the disposition of property, see Publication 544, *Sales and Other Dispositions of Assets*.

Depreciation

Unless you choose the standard mileage rate, as explained earlier, you can deduct a certain amount each year as a recovery of your cost of business property used for more than one year. This amount is called "depreciation." Employees use Form 2106 to figure their depreciation deduction. All other taxpayers use Form 4562.

Placed in service. A car generally is placed in service when it is available for use in your work or business, in the production of income, or in a personal activity. Depreciation begins when the car is ready for use in your work or business or for the production of income.

For purposes of computing depreciation, if you first start using the car entirely for personal use and later convert it to business use, the car is treated as placed in service on the date of conversion. Your basis is the lesser of the fair market value or the car's adjusted basis on the date of conversion.

The total amount of recovery (depreciation) and section 179 deductions you can claim is limited based on the date you placed your car in service.

Cars Placed in Service After June 18, 1984 — Maximum Limits¹

Placed in Service		Depreciation First Year ²	Depreciation Later Years
After	Before		
6/18/84	1/1/85	\$4,000	\$6,000 ³
12/31/84	4/3/85	\$4,100	\$6,200 ³
4/2/85	1/1/86	\$3,200	\$4,800 ³
12/31/85	1/1/87 ⁴	\$3,200	\$4,800 ³
12/31/86	1/1/89	\$2,560	\$4,100 2nd yr. 2,450 3rd yr. 1,475 ³
12/31/88	—	\$2,660	\$4,200 2nd yr. 2,550 3rd yr. 1,475 ³

¹These amounts must be reduced if the car is used less than 100% for business purposes.

²This is the maximum amount of your section 179 deduction and depreciation allowed for the tax year the car is placed in service.

³You could have elected to apply the amounts shown on the "After 12/31/86" line to cars placed in service after July 31, 1986. An investment credit of \$675 was allowed if the car qualified as transition property. The reduced investment credit did not apply.

⁴This amount is also the limit on deductions taken in years after the recovery period.

The list below shows the limits for the various periods.

Depreciation Limits

For cars placed in service after June 18, 1984, the depreciation deduction is limited.

Before 1985. The depreciation (recovery) deduction, including the section 179 deduction, for a car placed in service cannot be more than \$4,000 for the first tax year of the recovery period and \$6,000 for each later tax year.

After 1984 but before April 3, 1985. The depreciation deduction, including the section 179 deduction, cannot be more than \$4,100 for the first tax year of the recovery period and \$6,200 for each later tax year. This rule also applies to any car placed in service before August 1, 1985, if acquired under a binding contract in effect on and after April 1, 1985.

After April 2, 1985, but before 1987. The depreciation deduction, including the section 179 deduction, cannot be more than \$3,200 for the first tax year of the recovery period and \$4,800 for each later tax year.

After 1986 but before 1989. The depreciation deduction, including the section 179 deduction, cannot be more than \$2,560 for the first tax year of the recovery period, \$4,100 for the second year, \$2,450 for the third year, and \$1,475 for each later tax year.

After 1989. The depreciation deduction, including the section 179 deduction, cannot be more than \$2,660 for the first year of the recovery period, \$4,200 for the second year, \$2,550 for the third year, and \$1,475 for each later tax year.

The section 179 deduction is treated as a depreciation deduction for the tax year a car is placed in service. If you place a car in service in 1990 and elect the section 179 deduction, the section 179 deduction is treated as depreciation up to the \$2,660 limit for the first year of the recovery period.

If you place a car in service after June 18, 1984, and you use it less than 100% but more than 50% in your business or work, determine the depreciation deduction limits by multiplying the limit amount by the percentage of business and investment use during the tax year.

Example. On October 1, 1990, you buy a car and place it in service. You use it 80% in your business during 1990. Your total depreciation deduction, including section 179 deduction, for 1990 is limited to \$2,128 (80% of \$2,660). If the business use of the car remained at 80%, your deduction in 1991 would be limited to \$3,360 (80% of \$4,200). In 1992, your depreciation deduction is limited to \$2,040 (80% of \$2,550). After 1992, if your business use remained at 80%, your depreciation deduction would be limited to \$1,180 (80% of \$1,475).

Deductions in years after the recovery period. If, at the end of the recovery period, you have any **unrecovered basis** in your car attributable solely to the depreciation limitations and you continue to use it in your work or business, you can claim a deduction (depending on when you placed the car in service) for each tax year until you recover your basis in the car.

Before 1987. If you chose to use the alternate ACRS method, discussed later, or must use the straight line method (defined later) for your car, the recovery period extends 1 year beyond the recovery period used, because of the half-year convention (explained later). For example, you placed a car in service on September 10, 1986, and elected the alternate ACRS method over 5 years. The recovery period is treated for purposes of the limits as lasting to the end of the 6th year (1991).

Determination of any unrecovered basis is not necessary until the beginning of the 7th year (1992) after the car is placed in service.

After 1986. Your recovery period is 6 years: 5 year recovery life plus a half-year convention. Your recovery period is the same whether you use MACRS (discussed later) or straight line depreciation. Under MACRS, determine your unrecovered basis in the 7th year after the car was placed in service.

A deduction in a year after the recovery period that is based on the unrecovered basis is allowed only to the extent that a deduction for depreciation would be allowed for that year. For example, no deduction is allowed, under ACRS, for a year you dispose of your car or use it 100% for personal purposes.

Unrecovered basis is the unadjusted basis (defined later) of the car (not reduced by any section 179 deduction) minus the depreciation deductions (including any section 179 deduction), that would have been allowable if you had used the car 100% for business and investment use.

Example. On March 1, 1985, you bought and placed in service a car you use 100% in your business. The car cost \$31,800. You took a \$4,100 section 179 deduction for the car in 1985 which was the maximum amount of depreciation and section 179 deduction you could deduct for the car in 1985. Because you placed your car in service before 1986, you could take an investment credit. Your investment credit for the car was \$1,000, the maximum credit allowed at that time, which required that you reduce the car's basis by \$500 (50% of \$1,000). Your unadjusted basis for depreciation is \$27,200 (\$31,800 - \$4,100 - \$500). You continue to use the car 100% in your business.

The maximum depreciation allowable after 1985 was the lesser of \$6,200 or \$27,200 multiplied by the ACRS recovery percentage for each of the years 1986 and 1987. In 1986 your depreciation deduction for the car was \$6,200 (the lesser of \$6,200 or 38% of \$27,200). In 1987 your depreciation deduction for the car was \$6,200 (the lesser of \$6,200 or 37% of \$27,200). At the beginning of 1988, you had an unrecovered basis in the car of \$14,800 (\$31,300 unadjusted basis for this purpose - \$4,100 - \$6,200 - \$6,200 depreciation allowed). If you continued to use the car 100% for business in later years, you could claim \$6,200 in 1988 and 1989 and the remaining unrecovered basis of \$2,400 in 1990 as depreciation on the car.

If your business use of the car was less than 100% during any year, your depreciation deduction would be less than the maximum amount allowable for that year. However, in determining your unrecovered basis in the car, you would still reduce your unadjusted basis by the maximum amount allowable. Therefore, your unrecovered basis at the beginning of 1990 would still be \$2,400 in this example even if your actual depreciation deduction for any year was less than the maximum amount shown.

Modified Accelerated Cost Recovery System (MACRS)

The modified accelerated cost recovery system (MACRS) applies to all tangible property you place in service after 1986. Some taxpayers elected to use this method for assets placed in service after July 31, 1986, but before 1987. The maximum amount you can deduct is limited. See *Depreciation Limits*, earlier.

Depreciation limits. The depreciation limits on MACRS property, discussed earlier, are reduced only by the percentage of business use. They are not reduced if you use a vehicle for less than a full year. This means that you do not reduce the limit if you are using a half-year or mid-quarter convention (defined later). This applies even in the

year the vehicle is either placed in service or disposed of.

Recovery period. Under MACRS, any vehicle you drive is classified as **5-year property**. You depreciate the cost of any business car, truck, or van over a period of six years since your vehicle is generally treated as placed in service or disposed of in the middle of the year. See *Half-year convention* and *Mid-quarter convention*, later.

Depreciation methods. Use the double declining (200%) balance method over 5 years to depreciate property in the 5-year class. Change to the straight line method in the first tax year for which the straight line method, when applied to the adjusted basis at the beginning of the year, will give you a larger deduction than the double declining balance method. This usually occurs in the 4th year for cars. The depreciation tables, shown later, will automatically make the change for you.

You can choose to use the 150% declining balance method to depreciate your car. If you choose this method, you must depreciate your car over its class life instead of the recovery period. Once you make this choice, you cannot revoke it. For more information on the 150% declining balance method and class lives see *Modified Accelerated Cost Recovery System* in Publication 534, *Depreciation*.

Double declining balance method. To figure your MACRS deduction, first determine your basic rate of depreciation. This is done by dividing 1 by the recovery period (5 years for vehicles). This basic rate (20% for 5-year property) is multiplied by 2 to get the double declining (200%) balance rate of 40%. You then apply the appropriate convention to the first and last year of recovery. (See *Half-year convention*, and *Mid-quarter convention*, later.)

First year. To figure your depreciation, multiply your vehicle's adjusted basis (your cost reduced by the percentage of personal use and any section 179 deduction) by 40% and apply the appropriate convention.

Later years. First subtract from your adjusted basis the amount of depreciation taken in the first year. Then multiply this new adjusted basis by 40%. Continue this process for each year of recovery. At the point (year 4 for vehicles) where the straight line method will give you an equal or greater deduction than the double declining balance method, switch to straight line.

Last year. Apply the appropriate convention to the earlier of the year after the last year of recovery (generally year 6 for vehicles) or the year you dispose of your car. The salvage value is zero.

If your business use drops to 50% or less, you must change to the straight line method and you may have to recapture a portion of the depreciation you claimed in prior years. See *Partial Business Use*, later.

Example 1. In February 1988, Edna purchased an automobile for \$12,000 to use 100% in her plant and floral business. At night she parked the vehicle at her floral shop. She used another vehicle for personal purposes.

Edna did not purchase any other assets for use in her business during the year. She did not claim the section 179 deduction.

Under MACRS, her double declining balance rate is 40% (basic rate of 20% (1/5) multiplied by 2). For 1988 (the first year) she applied the half-year convention. Edna computed her 1988 depreciation to be \$2,400 (\$12,000 × 40% × 1/2).

In 1989, her business use of the car remained at 100%. She computed the adjusted basis of \$9,600 (\$12,000 - \$2,400) as of the beginning of 1989. Her second year depreciation was \$3,840 (\$9,600 × 40%).

Assuming 100% business use, Edna's adjusted basis as of 1-1-90 is \$5,760 (\$12,000 - \$2,400 - \$3,840) and her depreciation for 1990 is \$2,304 (\$5,760 × 40%).

In 1991, she will switch to the straight line method because it will give her a larger deduction than the double declining balance method. The car has 2½ years of recovery left and an adjusted basis of \$3,456 (\$12,000 — \$2,400 — \$3,840 — \$2,304). Edna's depreciation in 1991 and 1992 is \$1,382 (\$3,456 ÷ 2.5). In 1993 it is \$692 (\$3,456 — \$1,382 — \$1,382).

Edna can deduct her depreciation for each year in full because it is not more than the maximum amount allowable for cars placed in service after 1986, as explained earlier under *Depreciation Limits*.

Example 2. In June 1990, Karl, an outside dental supply salesman, purchased an automobile for \$25,400 to make sales calls in a territory that extends 200 miles around his home base. He uses his car 85% for his employer-related work. Karl does not elect to use section 179.

In 1990, Karl computes his MACRS deduction to be \$4,318 (\$25,400 × 40% × ½ × 85%). However, Karl's deduction is limited to \$2,261. This is the depreciation limit (\$2,660) multiplied by the business use percentage (85%).

Karl continues to use his car 85% for business. Karl's depreciation in the later years continues to be subject to deduction limits. Therefore, he computes his depreciation as follows: \$3,570 (\$4,200 × 85%) in 1991, \$2,168 (\$2,550 × 85%) in 1992, and \$1,254 (\$1,475 × 85%) in 1993, 1994, and 1995. If Karl continues to use his car for business after 1995, he cannot deduct more than \$1,475 multiplied by his business use percentage.

Alternative MACRS method. Instead of using the double declining balance method and switching to the straight line method, you can elect to use the straight line method, with the applicable convention, over the entire recovery period. The election to use the straight line method for a class of property applies to all property in that class that is placed in service in the year of the election. Once made, you cannot revoke this election. Under this method, salvage value is zero.

Half-year convention. The half-year convention treats all property placed in service (or disposed of) during a tax year, as placed in service (or disposed of) on the mid-point of that tax year.

You are allowed a half year of depreciation for the first year you place property in service, regardless of what month you actually first use the property. You take a full year of depreciation for each of the remaining years of the recovery period. If you hold the property for the entire recovery period (5 years for vehicles), you are allowed a half-year of depreciation in the year following the end of the recovery period (year 6 for vehicles). If you dispose of the property before the end of the recovery period, you are allowed a half-year of depreciation in the year of disposition.

Mid-quarter convention. You must use a mid-quarter convention instead of a half-year convention if:

- 1) You place property, including cars, in service during the last 3 months of your tax year, and
- 2) The total basis of these assets is more than 40% of the total basis of all property you place in service during the entire year.

In determining the total cost of property you placed in service during the year, disregard residential rental and nonresidential real property. Also, you can elect to disregard any property you acquire and dispose of within the same year.

Under the mid-quarter convention, all property you place in service (or dispose of) during any quarter of the tax year is treated as placed in service (or disposed of) at the mid-point of that quarter.

To figure your deduction for property subject to the mid-quarter convention, first compute your depreciation for the full year. Multiply the result by the percentage from the following table for the

quarter of the tax year you place the property in service. Do not use this table if you are a fiscal year taxpayer.

Quarter	Percentage
Jan. — Mar.	87.5%
Apr. — June	62.5%
July — Sept.	37.5%
Oct. — Dec.	12.5%

Example. During 1990, Katrina purchases and places into service a computer for \$5,000 in January, a word processor for \$1,000 in September, and a delivery van for \$23,000 in November. She does not elect section 179. All property is used 100% in her business. The combined total basis of all property she placed in service in 1990 is \$29,000 (\$5,000 + \$1,000 + \$23,000). Since the basis of the van (\$23,000), which was placed in service in the last quarter of the year, is more than 40% of the total basis of all property (\$29,000) she placed in service in 1990, she must use the mid-quarter convention to depreciate these three assets. These assets are 5-year property.

Katrina multiplies the basis of the computer, \$5,000, by 40% to get depreciation of \$2,000 for a full year. Katrina placed the computer in service during the first quarter of her tax year, so she multiplies the full year depreciation (\$2,000) by the amount from the table (87.5%) to get her 1990 depreciation deduction of \$1,750 for the computer.

Katrina multiplies the basis of the word processor, \$1,000, by 40% to get \$400, depreciation for a full year. She placed the word processor in service in the third quarter of her tax year, so she multiplies the \$400 by the amount from the table (37.5%) to get her 1990 depreciation of \$150.

Depreciation on the van is subject to the limits on vehicles (discussed earlier), in addition to the mid-quarter convention. Katrina multiplies the basis of the van (\$23,000) by 40% to get \$9,200. Since she placed the van in service in the last quarter of her tax year, she multiplies the result (\$9,200) by 12.5% to get \$1,150, her allowable depreciation on the van for 1990.

Had Katrina placed the van in service during one of the first 3 quarters of the year, she would have used the half-year convention, rather than the mid-quarter convention on all 3 assets. However, the first year depreciation on the van would have been limited to \$2,660.

Other rules under MACRS. For other rules under MACRS and a complete discussion of depreciation, see Publication 534, *Depreciation*.

MACRS Depreciation Tables

Instead of making the computations discussed earlier to figure your MACRS or Alternative MACRS depreciation deduction, you may want to use the optional tables shown on page 6. Find the percentage in the appropriate table based on the recovery year (column 1) and convention (half-year (column 2) or mid-quarter (columns 3–6)) that you are required to use. Once you have determined a column for the first recovery year, you continue using the percentages in that column for later years. Multiply the unadjusted basis of your vehicle by that percentage to determine your depreciation deduction. Your deduction cannot be more than the maximum depreciation limit (column 7 for cars placed in service after 1988).

The unadjusted basis of your vehicle is generally your cost minus any section 179 deduction you elected. If the vehicle is used only partly for business, multiply the cost by the business use percentage and then subtract the section 179 deduction to arrive at the unadjusted basis. If your business use percentage changes from year to year, you will have to refigure your unadjusted basis each year.

Example. Assume the same facts as in the previous example dealing with Katrina. However, she uses the *MACRS Depreciation Table* to compute her depreciation deduction.

Computer—cost \$5,000. Recovery year 1, first quarter percentage is 35%. The depreciation deduction is \$1,750 (\$5,000 × 35%).

Word processor—cost \$1,000. Recovery year 1, third quarter percentage is 15%. The depreciation deduction is \$150 (\$1,000 × 15%).

Van—cost \$23,000. Recovery year 1, fourth quarter percentage is 5%. The depreciation deduction is \$1,150 (\$23,000 × 5%).

For 1991, Katrina computes her depreciation deduction on these items as follows.

Computer—cost \$5,000. Recovery year 2, first quarter percentage is 26%. The depreciation deduction is \$1,300 (\$5,000 × 26%).

Word processor—cost \$1,000. Recovery year 2, third quarter percentage is 34%. The depreciation deduction is \$340 (\$1,000 × 34%).

Van—cost \$23,000. Recovery year 2, fourth quarter percentage is 38%. The depreciation deduction is \$8,740 (\$23,000 × 38%), however, the deduction is limited to \$4,200.

Accelerated Cost Recovery System (ACRS)

In prior years many taxpayers used the ACRS method to depreciate their business vehicles. Cars depreciated under the regular ACRS method are now fully depreciated. However, you may have chosen to use an alternate method of figuring your depreciation under ACRS. This method is based on the straight line method of depreciation (defined below) and is used in place of the ACRS recovery percentages. Under this method, you could have chosen a recovery period of 3, 5, or 12 years for all cars you placed in service during the tax year. The straight line recovery percentages are:

3 years	33.333%
5 years	20%
12 years	8.333%

If this applies to you, continue to depreciate your car under the rules in effect in the year you first placed your car in service.

Straight line method. Under the straight line method of depreciation you divide the car's adjusted basis by the number of years in the recovery period to figure each year's depreciation deduction. You must prorate the amount if the car is used only part of the year for business.

Other Depreciation Rules

Certain rules and definitions apply under both MACRS and ACRS.

Basis. The basis used for figuring depreciation is the same basis that would be used for figuring the gain on a sale. The original basis of your car is generally its cost. However, if you acquired the car other than by buying it (for example as a gift or an inheritance), see Publication 551, *Basis of Assets*, for special rules that may apply.

Adjusted basis. If an event occurs that changes your car's basis, the changed basis is called your adjusted basis. Some events, such as making substantial improvements to your car, will increase your basis. Most events, such as depreciation, amortization, an election to claim a section 179 deduction, or a deductible casualty loss, decrease your basis. You must also reduce your basis by any diesel fuel tax credit.

Unadjusted basis. Unadjusted basis is the amount you would use to figure gain on a sale not reduced for any depreciation, but reduced by the amount you properly amortize or by the amount you elect to deduct as the section 179 deduction. If you buy a car, your unadjusted basis is usually

its cost to you minus any section 179 deduction you elect. If you use your car only partly for business, and the business use percentage changes from year to year, you will have to refigure your unadjusted basis each year. Do this by multiplying the cost of the car by the percentage of business use for the current year. From this result, subtract the section 179 deduction you took in the year you placed the car in service.

Trade in. If you trade in a car used entirely in your business for another car that will be used entirely in your business, the unadjusted basis of the new car is the adjusted basis of the old car, plus any additional amount you pay for the new car.

Example. If you traded in a car that has an adjusted basis of \$3,000 for a new car, and in addition you pay cash of \$7,000 for the new car, the unadjusted basis of the new car is \$10,000 (the \$3,000 adjusted basis of the old car plus the \$7,000 cash paid). The unadjusted basis would be further modified if you claimed a section 179 deduction.

If you trade in a car (that you acquired after June 18, 1984) that you used partly in your business for a new car that you will use in your business, your basis for figuring depreciation deductions for the new car is the adjusted basis of the old car plus any additional amount you pay for the new car, minus the excess, if any, of:

- 1) The total of the amounts that would have been allowable as depreciation during the tax years before the trade if 100% of the use of the car had been business and investment use, over
- 2) The total of the amounts actually allowable as depreciation during those years.

Short tax year. The limit for depreciation in a short tax year (tax year of less than 12 months) is determined by multiplying the limit that would otherwise apply to the tax year by a fraction. The numerator (top number) of the fraction is the number of months or partial months in the short tax year and the denominator (bottom number) of the fraction is 12. For example, if you use your car 60% for business in a short tax year consisting of 6 months, the maximum amount you may claim as depreciation is 30% ($60\% \times \frac{6}{12}$) of the applicable limit.

Improvements. A major improvement to a car is treated as a new item of recovery property placed in service in the year the improvement is made. The limits on the depreciation deductions are determined by taking into account as a whole both the improvement and the car of which the improvement is a part. Your total depreciation deduction for the year on your car and any improvements cannot be more than the depreciation limit that applies for that year.

Disposition of a car. If you dispose of your car, you get no depreciation deduction for the tax year you dispose of it under either the ACRS or alternate ACRS method. However, under MACRS or the alternate MACRS method, you qualify for a half-year depreciation deduction for the year you dispose of the property.

If you dispose of your car, you may have a gain or loss on the transaction. The portion of any gain attributable to depreciation (including any section 179 deduction) you claimed on the car will be treated as ordinary income. For information on the disposition of property, see Publication 544. You may not have to recognize a gain if the transaction meets the nonrecognition rules.

Nonrecognition rules. No gain or loss is recognized on a like-kind exchange such as when a car is traded in for another car. In a trade-in situation the basis of the new property is the adjusted basis of the old property plus any additional payment.

The new (received in the exchange) car is treated as property placed in service in the year of the exchange. That year is the first recovery year for the new car.

Example. In December 1985, Rhoda purchased a car for \$32,000 and placed it in service for 100% use in her business. She did not elect a section 179 deduction. Rhoda elected a reduced investment credit instead of a basis reduction. Her unadjusted basis for the car was \$32,000. For 1985 Rhoda claimed depreciation (alternate ACRS method) on the car of \$3,200, and \$4,800 each year for 1986 through 1989. On September 20, 1990, Rhoda traded in the car and paid \$19,400 cash for a new car to be used 100% for business purposes. No depreciation is allowed for the old car in 1990. Rhoda's basis in the new car is \$29,000 (\$9,600 adjusted basis of the old car (\$32,000 less depreciation claimed of \$22,400) plus \$19,400 cash paid). The new car is treated as new recovery property placed in service in 1990. Rhoda does not elect any section 179 deduction for the car. Rhoda's depreciation for the new car in 1990 is \$2,660 (the lesser of \$2,660 or $\$29,000 \times 40\% \times \frac{1}{12}$).

Casualty or theft. For a casualty or theft, a gain results when the insurance or other reimbursement received is more than the adjusted basis of the lost or stolen property. If the proceeds are spent to acquire replacement property within a specified period of time, no gain is recognized. The basis of the replacement property is its cost

MACRS Depreciation Table for a Car (200% declining balance method)

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
Recovery Year	Half-Year Convention	Mid-Quarter Convention				Maximum Depreciation Limit (for cars placed in service after 1988)*
		Car placed in service 1st Quarter	Car placed in service 2nd Quarter	Car placed in service 3rd Quarter	Car placed in service 4th Quarter	
1	20.00%	35.00%	25.00%	15.00%	5.00%	\$2,660
2	32.00	26.00	30.00	34.00	38.00	\$4,200
3	19.20	15.60	18.00	20.40	22.80	\$2,550
4	11.52	11.01	11.37	12.24	13.68	\$1,475
5	11.52	11.01	11.37	11.30	10.94	\$1,475
6	5.76	1.38	4.26	7.06	9.58	\$1,475

*These amounts must be reduced if the car is used less than 100% for business purposes. The depreciation deduction for a car cannot exceed the amounts in column 7.

Alternative MACRS Depreciation Table for a Car (straight line method)

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
Recovery Year	Half-Year Convention	Mid-Quarter Convention				Maximum Depreciation Limit (for cars placed in service after 1988)*
		Car placed in service 1st Quarter	Car placed in service 2nd Quarter	Car placed in service 3rd Quarter	Car placed in service 4th Quarter	
1	10.00%	17.50 %	12.50%	7.50%	2.50%	\$2,660
2	20.00	20.00	20.00	20.00	20.00	\$4,200
3	20.00	20.00	20.00	20.00	20.00	\$2,550
4	20.00	20.00	20.00	20.00	20.00	\$1,475
5	20.00	20.00	20.00	20.00	20.00	\$1,475
6	10.00	2.50	7.50	12.50	17.50	\$1,475

*These amounts must be reduced if the car is used less than 100% for business purposes. The depreciation deduction for a car cannot exceed the amounts in column 7.

minus any gain that is not recognized. See Chapter 25, *Casualties, Thefts, and Condemnations* in Publication 334, *Tax Guide for Small Business*.

Percentage of business use. If your business use falls to 50% or less, you may have to include in your income any excess depreciation. See *Partial Business Use*, later, for a discussion of excess depreciation.

Fully depreciated. Depreciation was allowed in the following years at the rates shown below. The depreciation rate was included in the standard mileage rate for those years. These rates do not apply for any year in which the actual cost method was used. This depreciation reduces the basis of your car in figuring its adjusted basis when you dispose of it.

Year	Rate per Mile
1989 - 1990	11 cents
1988	10.5 cents
1987	10 cents
1986	9 cents
1983 - 1985	8 cents
1982	7.5 cents
1980 - 1981	7 cents

Example. In 1986 you bought a car for exclusive use in your business. The car cost \$6,000. From 1986 through 1989 you used the standard mileage rate to figure your car expense deduction. You drove your car at least 15,000 business miles each year. Your car is considered fully depreciated by the end of 1989. This is computed as follows.

Cost	6,000
Less Depreciation:	
1986 15,000 × .09	(1,350)
1987 15,000 × .10	(1,500)
1988 15,000 × .105	(1,575)
1989 15,000 × .11	(1,650)
Remaining basis	- 0 -

If you change to the actual cost method in 1990, you cannot take a depreciation deduction for that car.

Partial Business Use

You cannot take the section 179 deduction, and you must figure depreciation using the straight line method over a 5-year period (using the half-year convention), if you use your car (or other vehicle) 50% or less in a qualified business use (defined below). If you used your car more than 50% in a qualified business use in the year you placed it in service, but 50% or less in a qualified business use in a later year, you may have to recapture any excess depreciation. Any excess depreciation must be included in your gross income and added to your car's adjusted basis for the first tax year in which the car is used 50% or less in a qualified business use.

Qualified business use. A qualified business use is any use in your trade or business. Qualified business use does not include use for the production of income (investment use). However, after you have satisfied the 50% of business use requirement, you may combine your business and investment use to compute any allowable credit or deduction for a tax year.

Use of your car by another person. Any use of your car by another person is not treated as use in a trade or business unless that use:

- 1) Is directly connected with your business,
- 2) Is properly reported by you as income to the other person and, if required, you withhold tax on the income, or
- 3) Results in a payment of fair market rent.

Any payment to you for the use of your car is treated as a payment of rent for purposes of (3) earlier.

More-than-50%-use test. You meet this test if you use your car more than 50% in a qualified business use for any tax year. If you use your car for more than one purpose during the tax year, you must allocate the use to the various purposes. Property does not cease to be used more than 50% in a qualified business use by reason of a transfer at death.

Allocate the use on the basis of mileage. The percentage of qualified business use is figured by dividing the number of miles you drive your car for business purposes during the year by the total number of miles you drive the car during the year for any purpose.

You must meet the more-than-50%-use test each year of the recovery period for your car. Therefore, you must apply the more-than-50%-use test to your car for 6 years even if you fully depreciated it in the first 3 years under ACRS.

If a car is not used more than 50% in a qualified business use in the year it is placed in service, the depreciation deduction is figured using the straight line percentages over a 5-year recovery period (10% for the 1st and 6th years and 20% for the 2nd through 5th years). In addition, no section 179 deduction is allowed.

If you use your car more than 50% in a qualified business use in the tax year it is placed in service but not in a later tax year during the recovery period (6 years), you must determine your depreciation for that car using the straight line method over a 5-year recovery period as discussed earlier. You determine your depreciation for this tax year and any later tax years as if you had not met the more-than-50%-use test in the year in which it was placed in service. For example, if you met the more-than-50%-use test for the first 3 years (5 years if placed in service after 1986) of the recovery period but failed to meet it in the fourth year, you determine your depreciation for that year using 20% [$1 \div 5$ (years in recovery period)]]. You also will have to determine the amount of your excess depreciation, discussed next.

Excess depreciation. Any excess depreciation must be included in your gross income and added to your car's adjusted basis for the first tax year in which the car is not used more than 50% in a qualified business use. Excess depreciation is the excess, if any, of:

- 1) The amount of the depreciation deductions allowed (including any section 179 deduction) for the car for tax years in which the car was used more than 50% in a qualified business use, over
- 2) The amount of the depreciation deductions that would have been allowable for those years if the car had not been used more than 50% in a qualified business use for the year it was placed in service.

Example. On June 25, 1987, you bought a car for \$11,000 and placed it in service. You did not elect the section 179 deduction. You used the car exclusively in a qualified business use for 1987, 1988, and 1989. During 1990 you use the car 50% for business and 50% for personal purposes. Since you did not meet the more-than-50%-use test, you must include in gross income for 1990 your excess depreciation determined as follows:

Total depreciation claimed	\$ 7,832
Total depreciation allowable:	
1987—10% of \$11,000	\$1,100
1988—20% of \$11,000	2,200
1989—20% of \$11,000	2,200
	5,500
Excess depreciation	\$ 2,332

In 1990 you must include \$2,332 in your gross income. Your adjusted basis for the car is also increased by \$2,332. Your 1990 depreciation deduction is \$1,100 (\$11,000 (unadjusted basis)

$\times 50\%$ (business use percentage) $\div 5$ years (useful life)).

Use Form 4797, *Sales of Business Property*, to report the excess depreciation.

Change from personal to business use. If you change the use of a car from 100% personal use to business use during the tax year and you have no records for the time before the change to business use, figure the percent of business use for the year as follows:

- 1) Determine the percent of business use for the period following the change by dividing business miles by total miles driven during that period.
- 2) Multiply that percentage by a fraction, the numerator (top number) of which is the number of months the car is used for business and the denominator (bottom number) of which is 12.

Example. You use a car for personal purposes only during the first 6 months of the year. During the last 6 months of the year you drive the car a total of 15,000 miles of which 12,000 miles are for business. This gives you a business use percentage of 80% ($12,000 \div 15,000$) for that period. Your business use for the year is 40% ($80\% \times \frac{6}{12}$).

Leasing a Car

If you lease a car that you use in your business or work, you can deduct the part of each lease payment that is for the use of the car in your business or work. You cannot deduct any part of a lease payment that is for commuting to your regular job or other personal use of the car. You must spread any advance payments over the entire lease period. You cannot deduct any payments you make to buy a car even if the payments are called lease payments.

Lease with option to buy. A lease with an option to buy the property may be a lease or a purchase contract, depending on the intent of the parties. Important considerations in determining intent include whether any equity is obtained, whether any interest is paid, and whether the fair market value is less than the "lease" payment or the option price when the option to purchase can be exercised.

Inclusion Amount

If you leased a car after June 18, 1984, that you use in your business or work, you may have to include in your income for each tax year you lease the car an amount called the "inclusion amount." For information on reporting inclusion amounts, see *Vehicle rentals* under *How to Report*, later.

This **inclusion amount** is a percentage of part of the fair market value of the leased car multiplied by the percentage of business and investment use of the car for the tax year. The inclusion amount is prorated for the number of days of the lease term included in the tax year. If you use the leased car 50% or less for business, you may have to include in your income an **additional inclusion amount**. These additions to income effectively limit your deduction for lease payments so that it equals the depreciation deduction you would have on the car if you owned it. In determining the inclusion amount, different rules apply depending on when the car is leased.

Cars Leased After June 18, 1984, and Before 1987

If you first lease a car after June 18, 1984, but before 1987, figure the inclusion amount using the following rules. If you first lease a car after June 18, 1984, and before 1987, you are not required to include an inclusion amount in your

gross income in the last taxable year of your lease. This rule, however, does not apply to the additional inclusion amount, discussed later.

Cars leased before April 3, 1985. If you leased a car after June 18, 1984, and before April 3, 1985, for a lease term of 30 days or more, you must include in your gross income an inclusion amount based on the rules listed below. The regular inclusion amount applies only if the fair market value of the car is more than \$16,500. These rules also apply to a car you leased under a binding contract entered into before April 3, 1985, and which is in effect at all times thereafter, but only if the car is used under the lease before August 1, 1985.

The inclusion amount is:

7.5% of the excess (if any) of the car's fair market value over \$16,500 for each of the first 3 tax years during which a car is leased. If the lessor allowed you to claim the investment credit on the car, use 3.5% to determine the inclusion amount for the first 3 tax years.

6% of the excess (if any) of the car's fair market value over \$22,500 for the fourth tax year during which a car is leased.

6% of the excess (if any) of the car's fair market value over \$28,500 for the fifth tax year during which a car is leased.

6% of the excess (if any) of the car's fair market value over \$34,500 for the sixth tax year during which a car is leased.

For the seventh and later years during which the car is leased, the inclusion amount is 6% of the excess (if any) of the car's fair market value over the sum of:

- 1) \$16,500, and

- 2) \$6,000 multiplied by the number of tax years in excess of 3 years.

The fair market value is the value on the first day of the lease term. If the capitalized cost of a car is specified in the lease agreement, that amount is treated as the fair market value.

Fair market value is the price at which the property would change hands between a buyer and a seller, neither being required to buy or sell, and both having reasonable knowledge of all the necessary facts. Sales of similar property on or about the same date may be helpful in figuring the fair market value of the property.

Example. On February 1, 1985, you leased for 7 years and placed in service a car to be used exclusively in your business. The lease agreement specified that the capitalized cost of the car was \$35,000. You can deduct the rent paid and you must include \$30 in your income. The \$30 inclusion amount for 1990 (the 6th year of the lease) is the \$35,000 fair market value minus \$34,500 multiplied by 6% ($\$35,000 - \$34,500 \times .06 = \$30$).

Cars leased after April 2, 1985, but before January 1, 1987. If you leased a car after April 2, 1985, but before January 1, 1987, for a lease term of 30 days or more, you must determine an inclusion amount, an additional inclusion amount, or both. For 1990, the regular inclusion amount applies only if the fair market value of the car when the lease began was more than \$18,000. If the fair market value on the first day of the lease is \$50,000 or less, use the tables at the end of this publication. If the value is more than \$50,000, you must use the formula shown in section 1.280F-5T(e)(4) of the Income Tax Regulations or, if you claimed the investment credit on the car, the formula shown in Revenue Ruling 86-87.

The inclusion amount for the first 6 tax years of the lease is determined as follows:

- 1) Determine the dollar amount from the tables,
- 2) Prorate the dollar amount for the number of days of the lease term included in the tax year, and
- 3) Multiply the prorated amount by the percentage of business and investment use for the tax year.

Tables. You must use the table near the end of this publication if the fair market value is \$50,000 or less. Use Table I to find the dollar amount for tax years 4, 5, and 6. You use the fair market value on the first day of the lease and the tax year in which the car is used under the lease to determine the dollar amount. If the fair market value is \$18,000 or less, you do not have an inclusion amount.

Seventh and later years. If the fair market value on the first day of the lease is more than \$32,400, you must determine an inclusion amount for the seventh and later tax years of the lease. For these years the inclusion amount is 6% of the fair market value over the sum of:

- 1) \$13,200, plus
- 2) \$4,800 multiplied by the number of tax years in excess of 3 years.

For example, you must determine an inclusion amount in the seventh year, if the fair market value on the first day of the lease was more than \$32,400 [$\$13,200 + (\$4,800 \times 4)$], and in the eighth year, if the fair market value was more than \$37,200 [$\$13,200 + (\$4,800 \times 5)$].

Example 1. On July 15, 1985, you lease and place in service a car with a fair market value of \$45,300. The lease is for a period of 7 years,

Inclusion Amount

Date Leased	Lease Year				
	1st 3 years	4th	5th	6th	Later years
Before 4/3/85 Applies if fair market value is over \$16,500	*	*	*	Fair Market Value MINUS \$34,500 MULTIPLIED BY 6% ..	Fair Market Value MINUS \$16,500 MINUS \$6,000 multiplied by lease year minus 3 MULTIPLIED BY 6% ..
After 4/2/85 but before 1/1/87 Applies if fair market value is over \$11,250	*	Amount from Table I MULTIPLIED BY Number of days leased that year ÷ 365*** MULTIPLIED BY Percentage of business and investment use that year			Fair Market Value MINUS \$13,200 MINUS \$4,300 multiplied by lease year minus 3 MULTIPLIED BY 6%
After 1986 Applies if fair market value is over \$12,800	Amount from Table II or III MULTIPLIED BY Number of days leased that year ÷ 365*** MULTIPLIED BY Percentage of business and investment use that year				

* See the text of this publication. These amounts apply only to tax years ending before 1990.

** Prorate for percentage of business and investment use and for number of days leased that year.

*** Use 366 in leap years.

during which you use the car exclusively in your business. 1990 is the sixth tax year of the lease. For tax year 1990 you use Table I to determine that you must include \$1,074 in your gross income.

Additional inclusion amount. This additional inclusion amount applies in 1990 only if all of the following are true:

- 1) You leased the car after April 2, 1985, and before January 1, 1987.
- 2) The first year you did not use the car over 50% for business or work was 1990.
- 3) The fair market value of the car at the beginning of the lease was \$11,250 or less, and
- 4) The lease term is 4 or more years.

If items (1) through (4) above apply to you, you must include this additional inclusion amount in your gross income on your 1990 tax return.

If the fair market value of the car is **\$11,250 or less**, the additional inclusion amount is determined by multiplying the fair market value of the car by the average business and investment use and by the applicable percentage from the following table.

Applicable Percentages

Tax year of lease	
Fourth year	1.7%
Fifth year	0.5%

The average business and investment use is the average of the business and investment use of the car for the first tax year in which the business use percentage is 50% or less and all prior tax years in which the car is leased. For example, if your car had 100% of business and investment use from 1986 through 1989, but only 45% in 1990, your average business and investment use is 89% $[(100\% \times 4 \text{ years}) + 45\%] \div 5 \text{ years}$.

Example 2. Assume the same facts as in Example 1, except that the fair market value was \$10,000, you leased the car on July 15, 1986, and use the car only 30% in your business during 1990. You must include in gross income an additional inclusion amount on your 1990 tax return (the first tax year in which the car is not used predominantly in your business). The average business use is 86% $[(100\% \times 4 \text{ years}) + 30\%] \div 5 \text{ years} = 86\%$. The additional inclusion amount of \$43 $[\$10,000 \text{ fair market value} \times 0.5\% \text{ applicable percentage} \times 86\% \text{ average business use}]$ is based on this average business use. You do not have to include a regular inclusion amount because the fair market value is less than \$18,000.

Cars Leased After 1986

If you leased a car after December 31, 1986, for a lease term of 30 days or more, and the fair market value (discussed earlier) of the car is more than \$12,800, you must include in your gross income an inclusion amount each tax year during which you lease the car.

Use Table II or Table III (depending on the year first placed in service) near the end of this publication to determine the inclusion amount if the fair market value of the car is \$100,000 or less. For each tax year during which you lease the car, the inclusion amount is determined as follows:

- 1) Determine the dollar amount from Table II or III, as described below.
- 2) Prorate the dollar amount from Table II or III for the number of days of the lease term included in the tax year, and
- 3) Multiply the prorated amount by the percentage of business and investment use for the tax year.

To determine the dollar amount from Table II or III, use the fair market value of the car on the first day of the lease term to find the appropriate line

of the table. Use the tax year in which the car is used under the lease to find the appropriate column of the table; however, for the **last** tax year of the lease, use the dollar amount for the **preceding** year. For example, if you lease a car with a fair market value of \$25,500, under a 2-year lease that begins in 1988 and ends in 1990, the dollar amount from Table II is \$177 for 1988 (first tax year of the lease), \$386 for 1989 (second tax year of the lease), and \$386 for 1990. Since 1990 is the last tax year of the lease, you use the dollar amount for the preceding (second) year rather than the third year.

Example. On January 17, 1988, you leased a car for 3 years and placed it in service for use in your business. The car had a fair market value of \$18,250 on the first day of the lease term. You use the car 75% for your business and 25% for personal purposes during each year of the lease. For tax years 1988 through 1991, you must include the following amounts in gross income:

Tax year	Dollar amount	Proration	Business use	Inclusion Amount
1988	\$76	349/366	75%	\$54
1989	166	365/365	75%	125
1990	246	365/365	75%	185
1991	246	16/365	75%	8

Note. The **additional inclusion amount**, discussed earlier, that applies to cars leased before 1987, does not apply to cars first leased after 1986.

Vehicle Provided by Employer

If your employer provided you with the use or availability of a vehicle, you received a fringe benefit. Generally, the value of such use or availability must be included in your income as compensation, unless the use of the vehicle qualifies as a working condition fringe or the vehicle is a qualified nonpersonal use vehicle (as described later). A vehicle is any motorized, wheeled vehicle manufactured primarily for use on public streets, roads, and highways. Employers should get Publication 535 for a discussion of fringe benefits.

Working condition fringe. A working condition fringe is any property or service provided to you by your employer that you could deduct as an employee business expense if you had paid for the property or service. The use of an employer-provided vehicle in that employer's business is a working condition fringe and its value is not included in your income. However, if you also use that vehicle for nondeductible commuting or other personal purposes or use it in another trade or business, the value of such use is includable in your income.

Example. You have the use of an employer-provided car. The value of the availability of the car for a full year is \$2,000. You drive the car 6,000 miles for your employer's business and 2,000 miles for personal reasons. The value of the nontaxable working condition fringe is \$1,500. This is figured by multiplying the value of the benefit (\$2,000) by a fraction, the numerator of which is the business-use mileage (6,000) and the denominator of which is the total mileage (8,000). The amount includable in your income because of the availability of the employer-provided car is \$500 $(\$2,000 - \$1,500)$.

Parking. The value of parking provided by your employer on or near the employer's business premises is a working condition fringe and is therefore excluded from income. The exclusion applies whether your employer owns or rents the parking space.

A reimbursement or allowance paid to you by your employer for renting a parking space on or near the business premises of your employer is also a working condition fringe which is excluded from income. However, you must actually use the cash received for renting a parking space.

The parking space working condition fringe does not apply to any parking facility or space located on property which you own or lease for residential purposes.

Employee. The following persons are considered employees for purposes of determining whether the value of an employer-provided vehicle may be excluded as a working condition fringe.

- 1) Any individual currently employed by that employer.
- 2) Any partner performing services for the partnership.
- 3) Any director of the employer, and
- 4) Any independent contractor performing services for the employer. However, the exclusion for parking does not apply to an independent contractor.

Records must be maintained to substantiate the working condition fringe. See *Recordkeeping*, discussed later.

Qualified nonpersonal use vehicles. All of your use of a qualified nonpersonal use vehicle qualifies as a working-condition fringe and, therefore, 100% of the value of that use is excluded from your income. A qualified nonpersonal use vehicle is any vehicle that is not likely to be used more than minimally for personal purposes because of the way it is designed. Qualified nonpersonal use vehicles include:

- 1) Clearly marked police and fire vehicles,
- 2) Unmarked vehicles used by law enforcement officers (explained later) if the use is officially authorized,
- 3) Ambulances used as such,
- 4) Hearses used as such,
- 5) Any vehicle that is designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds,
- 6) Delivery trucks with seating for the driver only, or for the driver plus a folding jump seat,
- 7) Passenger buses used as such with a capacity of at least 20 passengers,
- 8) School buses, and
- 9) Tractors and other special purpose farm vehicles.

Clearly marked police or fire vehicles. A police or fire vehicle is a vehicle, owned or leased by a governmental unit (or any of its agencies or instrumentalities), that is required to be used for commuting by a police officer or fire fighter who is on call at all times. Any personal use (other than commuting) of the vehicle outside the limit of the police officer's arrest powers or the fire fighter's obligation to respond to an emergency must be prohibited by such governmental unit. A police or fire vehicle is clearly marked if, through a painted symbol or words, it is easy to see that the vehicle is a police or fire vehicle. A marking on a license plate is **not** a clear marking for this purpose.

Unmarked law enforcement vehicles. Any personal use of an unmarked law enforcement vehicle must be authorized by the federal, state, county, or local governmental agency or department that owns or leases the vehicle and employs the officer. The personal use must be necessary to help enforce the law, such as being able to report directly from home to a stakeout site or to an emergency. Use of an unmarked vehicle for vacation or recreation trips cannot qualify as an authorized use.

Law enforcement officer. A law enforcement officer is a person who is employed on a full-time basis by a governmental unit that is responsible

for preventing or investigating crimes involving injury to persons or property (including catching or detaining persons for such crimes), who is allowed by law to carry firearms, to execute search warrants, and to make arrests (other than merely a citizen's arrest), and who regularly carries firearms (except when working undercover). It may include an arson investigator if the investigator otherwise meets these requirements.

Trucks and vans. A pickup truck or van is not considered a qualified nonpersonal use vehicle unless it has been specially modified with the result that it is not likely to be used more than minimally for personal purposes. The following are guidelines that a pickup truck or van can meet to be a qualified nonpersonal use vehicle. Even if these guidelines are not met, the vehicle may still qualify, based upon the facts. In such a case, contact your local IRS district director for further guidance.

Pickup truck. A pickup truck with a loaded gross vehicle weight not over 14,000 pounds will qualify if it is clearly marked with permanently affixed decals or with special painting or other advertising associated with the employer's trade, business, or function and is either:

- 1) Equipped with at least one of the following: a hydraulic lift gate, permanently installed tanks or drums, permanently installed side boards or panels that materially raise the level of the sides of the truck bed, or other heavy equipment (such as an electric generator, welder, boom, or crane used to tow automobiles and other vehicles), or
- 2) Actually used primarily for transporting a particular type of load (other than over the public highways) in connection with a construction, manufacturing, processing, farming, mining, drilling, timbering or other similar operation for which it has been specially designed or modified to a significant degree.

Van. A van with a loaded gross vehicle weight not over 14,000 pounds will qualify if it is clearly marked with permanently affixed decals or with special painting or other advertising associated with the employer's trade, business, or function, and has a seat for the driver only or the driver and one other person, and either:

- 1) Permanent shelving has been installed that fills most of the cargo area, or
- 2) The cargo area is open and the van constantly (during both working and nonworking hours) carries merchandise, material, or equipment used in the employer's trade, business, or function.

Qualified automobile demonstration use. If you are a full-time automobile salesperson, qualified automobile demonstration use is a working condition fringe and, therefore, is excluded from your income. Qualified automobile demonstration use is any use of a demonstration automobile in the dealer's sales area if:

- 1) The automobile is provided mainly so you can better perform services for your employer, and
- 2) There are substantial restrictions on your personal use of the automobile.

A demonstration automobile is an automobile that is currently in the automobile dealer's inventory and available for test drives by customers during your normal business hours.

Full-time automobile salesperson. You are a full-time automobile salesperson, even if that is not your formal job title, if you are employed by an automobile dealer and you:

- 1) Customarily spend at least half of a normal business day performing the functions of a floor salesperson or sales manager,
- 2) Directly engage in substantial promotion and negotiation of sales to customers,

3) Customarily work a number of hours considered full-time in the industry (at a rate of at least 1,000 hours per year), and

4) Earn at least 25% of your gross income from the dealership directly as a result of the activities above.

You are not considered a full-time salesperson unless the above requirements are met. The value of the use of a demonstration automobile by anyone other than a full-time automobile salesperson, such as a mechanic or part-time salesman, is not excludable from income.

Restrictions on personal use. Substantial restrictions on your personal use of a demonstration automobile exist when all of the following conditions are met:

- 1) Use by anyone other than you and other full-time salespersons (such as use by members of your family) is prohibited,
- 2) Use for personal vacation trips is prohibited,
- 3) Storage of personal possessions in the automobile is prohibited, and
- 4) Use outside of your normal working hours is limited to a certain number of miles.

The sales area includes the geographic area around the dealer's office from which the office regularly gets customers. For a particular full-time salesperson, the sales area is the larger of the area within a 75-mile radius of the sales office or the one-way commuting distance for that salesperson.

Taxable Value of Vehicle

Except as explained earlier, you must include in your income the value of the use of a vehicle provided by your employer. The amount you must include is the excess of the fair market value of the benefit over the amount you paid for the benefit. Your employer will use either general valuation principles or one of the special valuation rules to value the use of the vehicle. The following is a brief description of these valuation rules. Publication 535 has a full discussion of the valuation rules.

General valuation principles. In general, the value of the availability of an employer-provided vehicle is the amount an unrelated third party would charge a person to obtain (lease or purchase) the same or a comparable vehicle on the same or comparable terms in the geographic area in which the vehicle is available for use. You cannot use a cents-per-mile rate unless the same or comparable vehicle could be leased on a cents-per-mile basis. A comparable lease term includes the amount of time that the vehicle is available for your use, for example, a one-year period.

Special valuation rules. There are three special valuation rules for valuing the use or availability of an employer-provided vehicle. If your employer uses one of these rules, you must use either that same rule or the general valuation principles explained above.

Automobile lease valuation rule. Under this rule, if your employer provides you with an automobile that is available to you for an entire calendar year, the value of the benefit is the annual lease value of that automobile. The annual lease value is determined from a table which can be found in Publication 535. If the automobile is not available to you for the entire year, the value is determined by using a pro-rated annual lease value or a daily lease value, whichever applies.

Vehicle cents-per-mile rule. Under this rule, the standard mileage rate, which is 26 cents per mile, is multiplied by the number of miles you use the vehicle for personal purposes. If your employer does not provide the fuel for the vehicle, the rate may be reduced by up to 5.5 cents per

mile. Business miles must be substantiated and subtracted from total miles to determine personal miles.

To qualify for use of this rule, the vehicle must be:

- 1) Used at least 50% in the employer's trade or business throughout the calendar year (or such shorter period as the vehicle may be owned or leased), or
- 2) Generally used each workday to transport at least three employees in an employer-sponsored commuting pool, or
- 3) Driven at least 10,000 miles in that year and used primarily by employees.

This rule cannot be used for an automobile first made available to an employee for personal use in 1990 if its fair market value is more than \$13,200 at the time it is first made available.

Commuting valuation rule. Under this rule, the value of the commuting use of an employer-provided vehicle is \$1.50 per one-way commute or \$3.00 per round trip. You must be required to commute in the vehicle, your employer must have a written policy against use of the vehicle for personal purposes other than commuting and minimal personal use, and you must not use the vehicle for personal purposes other than commuting and minimal personal use. Other requirements are discussed in Publication 535.

Applying the valuation rules. If your employer chooses to use a special valuation rule, you must be notified of the election by the later of January 31 of the calendar year for which the election is to apply, or 30 days after you are first provided the vehicle. The notice will tell you what records you should keep. Your employer's election to use a special valuation stays in effect until your employer notifies you otherwise.

You must use general valuation principles to value the use or availability of a fringe benefit unless your employer chooses to use one of the special valuation rules. If your employer uses a special valuation rule, you must use either that same valuation rule or the general valuation principles. If both you and your employer properly use the same valuation method, you must include in income the value determined by your employer minus any amount you paid for the benefit.

Reporting by Your Employer

Your employer will report the value of the use of an employer-provided vehicle that is included in your income on your Form W-2, *Wage and Tax Statement*. On 1990 Forms W-2 the amount of the benefit will be included in box 10, *Wages, tips, other compensation*, box 12, *Social security wages*, and box 16, *Fringe benefits included in Box 10*.

Withholding. Your employer can elect not to withhold income tax on the value of your personal use of an employer-provided vehicle. However, he or she must withhold employment taxes (such as social security). Your employer must give you written notification of an election not to withhold by the later of January 31 of the year for which the election applies or, within 30 days after the date your employer first provides the vehicle to you.

If your employer makes this election, you may not have enough income tax withheld and, therefore, you may owe estimated tax payments. You can increase your income tax withholding on your wages by filing a new Form W-4, *Employee's Withholding Allowance Certificate*. If you do not increase your withholding or make estimated tax payments, you may be liable for a penalty for underpayment of estimated taxes. See Publication 505, *Tax Withholding and Estimated Tax*, for information on this penalty.

Value reported. Your employer can figure and report either the actual value of your personal use of the vehicle or the value of the vehicle as if you used it entirely for personal purposes (100% income inclusion). The 100% income inclusion method cannot be used if the value of the use of the vehicle is determined under the vehicle cents-per-mile or commuting valuation special methods. If your employer includes 100% in your income, deduct the value of your business use of the vehicle by completing Form 2106, *Employee Business Expenses*. Include the entire value of the employer-provided vehicle on line 25 and complete the remainder of the form.

If less than the full annual lease value was included on your Form W-2, this means that your Form W-2 only includes the value of your personal use of the vehicle. Do not enter this value on your Form 2106; it is not deductible. But you must enter the value of your business use on line 7 of Form 2106 if you are claiming a deduction for vehicle expenses.

Period covered. For any fringe benefit, your employer may elect a special accounting period. This allows your employer to treat the value of benefits actually provided during the last two months of the calendar year (or any shorter period) as paid during the next calendar year. If your employer elects the special accounting rule, you must use it also. Therefore, your deductions related to a fringe benefit are allowable only in the year your employer includes the value of the fringe benefit in your income. Your employer must notify you if this election is made and of the period involved. You must receive the notice at or near the time you receive your Form W-2.

Example. For 1990 you are provided a car by your employer for both business and personal use. You have the car for the entire year. Your employer includes 100% of the value of the use of the car in your income. He uses the special accounting period and elects to treat the value of the use of the car during the last two months of 1990 as paid in 1991. For 1990 you can deduct only that part of the value that is attributable to your business use of the car for the first ten months of 1990. The part attributable to the last two months is deductible in 1991. However, any *unreimbursed* expenses you incurred during the last two months of 1990 that relate to your business use of the car (such as fuel, parking, etc.) can be deducted for 1990.

Recordkeeping

To claim a credit or deduction for your car that you use in your business or work, you must be able to prove certain items. You must be able to prove these items by adequate records or sufficient evidence, either written or oral, that will support your own statement. Estimates or approximations do not qualify as proof of an expense.

Note. These rules do not apply to qualified non-personal use vehicles as discussed under *Vehicle Provided by Employer*, earlier.

You must be able to prove:

- 1) The amount of each separate expense for a car, such as the cost of buying a car, the cost of capital improvements, lease payments, the cost of maintenance and repairs, or other expenses.
- 2) The mileage for each business or investment use of the car or other means of transportation, and the total miles for the tax year.
- 3) The date of the expense or use.
- 4) The business or investment reason for the expense or use of the car.

Adequate records. You should keep the proof you need for these items in an account book, diary, log, statement of expense, trip sheet, or

similar record supported by adequate documentary evidence. Written evidence has considerably more value than oral evidence alone.

Timely recordkeeping. You do not have to write down the elements of every expense at the time of the expense. However, a record of the elements of an expense or of a business use made at or near the time of the expense or use supported by sufficient documentary evidence, has more value than a statement prepared later when generally there is a lack of accurate recall. A log maintained on a weekly basis, which accounts for use during the week, is considered a record made at or near the time of the expense or use. You do not have to record information that duplicates information shown on a receipt as long as your records and receipts complement each other in an orderly manner.

An adequate record contains sufficient information for each element of every business or investment use. The level of detail required to substantiate the use may vary depending on the facts and circumstances. For example, if your only business use of a car is to make deliveries to customers of your employer on an established route, you can satisfy the requirements by recording the length of the delivery route once, the date of each trip at or near the time of the trips, and the total miles you drove the car during the tax year. You could also establish the date of each trip with a receipt, record of delivery, or other documentary evidence.

Uses which can be considered part of a single use, such as a round trip or uninterrupted business use, can be accounted for by a single record. For example, deliveries at several different locations on a route that begins and ends at your employer's business premises and that may include a stop at the business premises between two deliveries can be accounted for by a single record of miles driven. Minimal personal use, such as a stop for lunch on the way between two business stops, is not an interruption of business use.

Generally, an adequate record must be written. However, a record prepared in a computer memory device with the aid of a logging program is considered an adequate record.

A receipt is ordinarily the best evidence to prove the amount of an expense.

Canceled check. A canceled check, together with a bill from the payee, ordinarily establishes the cost. However, a canceled check does not prove a business expense without other evidence to show that it was for a business purpose.

Business purpose. A written statement of the business purpose of an expense is generally required. However, the degree of proof varies according to the circumstances in each case. If the business purpose of an expense is clear from the surrounding circumstances, a written explanation is not required.

Example. A sales representative who calls on customers on an established sales route does not have to submit a written explanation of the business purpose for traveling that route.

Confidential information relating to an element of a deductible expense, such as the place or business purpose, need not be put in your account book, diary, or other record. However, the information has to be recorded elsewhere at or near the time of the expense and be available to fully prove that element of the expense.

Incomplete records. If you do not have adequate records to prove an element of an expense, then you must prove the element by:

- 1) Your own statement, whether written or oral, containing specific information in detail as to the element, and
- 2) Other supporting evidence sufficient to establish the element.

In some cases, circumstantial evidence may support the amount of business and investment

use. For example, the nature of your work, such as deliveries, provides circumstantial evidence of the fact that you use your car for business purposes. Invoices of deliveries establish when you used the car for business.

Sampling. You can maintain an adequate record for parts of a tax year and use that record to substantiate the amount of business or investment use for the entire year if you can demonstrate by other evidence that the periods for which an adequate record is kept are representative of the use throughout the tax year.

Example. You use your car for local business transportation to visit the offices of clients, meet with suppliers and other subcontractors, and pick up and deliver items to clients. There is no other business use of the car, but you and other members of your family use the car for personal purposes. You maintain adequate records during the first week of each month that show that 75% of the use of the car is for business. Invoices and bills show that your business use continued at the same rate during the later weeks of each month. Your weekly records are representative of the use of the car each month and are sufficient evidence to support the percentage of business use for the year.

Destroyed records. You can substantiate a deduction by reconstructing your records or expenses if you cannot produce a receipt for reasons beyond your control, such as fire, flood, or other casualty.

The Internal Revenue Service may require additional information to clarify or to establish the accuracy or reliability of information contained in your records, statements, testimony, or documentary evidence before a deduction is allowed.

Keeping records and receipts. You must keep proof to support your claim to a deduction as long as your income tax return can be examined. Generally, it will be necessary for you to keep your records for 3 years from the date you file the income tax return on which the deduction is claimed. A return filed early is considered as filed on the due date.

You must keep records of business use for each year of the recovery period for your car. See *More-than-50%-use test*, discussed earlier under *Partial Business Use*.

Employees who give their records and documentation to their employers and are reimbursed for their expenses generally do not have to keep duplicate copies of this information. However, you may be required to prove your expenses if:

- 1) You claim deductions for expenses that are more than reimbursements,
- 2) Your expenses are reimbursed under a nonaccountable plan,
- 3) Your employer does not use adequate accounting procedures to verify expense accounts, or
- 4) You are related to your employer as discussed later.

Employer-Provided Vehicles

If your employer provides you with a vehicle, you have received a fringe benefit that may be included in your income unless it qualifies as a working condition fringe. See *Vehicle Provided by Employer*, earlier in this publication.

Written policy statement. Generally, you must keep records, as previously discussed, to substantiate the business use of the vehicle. However, if your employer implements a written policy statement of no personal use (or no personal use except for commuting) of employer-provided vehicles, that policy statement will qualify as sufficient

supporting evidence and satisfy the substantiation requirements.

No personal use. Instead of having to prove the business use of an employer-provided vehicle, you can treat all use of the vehicle as business use if all of the following conditions are met:

- 1) The vehicle is owned or leased by your employer and is provided to one or more employees for use in connection with your employer's trade or business,
- 2) When not being used in your employer's trade or business, the vehicle is kept on your employer's business premises, unless it is temporarily located elsewhere (for example, in a garage for maintenance or repairs),
- 3) No employee using the vehicle lives at your employer's business premises,
- 4) Under your employer's written policy statement, you, or any individual whose use would be taxable to you (such as a family member), cannot use the vehicle for personal purposes, except for minimal personal use (such as a stop for lunch between deliveries), and
- 5) Except for minimal personal use, neither you, nor any individual whose use would be taxable to you, uses the vehicle for any personal purpose.

There must be evidence that would enable the Internal Revenue Service to determine whether the use of the vehicle meets these conditions.

No personal use except for commuting. Instead of having to prove the business use of an employer-provided vehicle, you can prove any exclusion allowed for a working condition fringe by meeting all the following conditions:

- 1) The vehicle is owned or leased by your employer and is provided to one or more employees for use in connection with your employer's trade or business and is used in that business,
- 2) Your employer, for bona fide noncompensatory business reasons, requires you to commute to or from work in the vehicle,
- 3) Under your employer's written policy statement, you, or any individual whose use would be taxable to you, cannot use the vehicle for personal purposes, other than for commuting or minimal personal use (such as a stop for a personal errand on the way between a business delivery and your home),
- 4) Except for minimal personal use, you (or any individual whose use would be taxable to you) do not use the vehicle for any personal purpose other than commuting,
- 5) You are not a control employee (defined later), and
- 6) You include in gross income the commuting value determined by your employer to the extent that you do not reimburse your employer for the commuting use. Commuting value is determined under the rules discussed under *Taxable Value of Vehicle in the Vehicle Provided by Employer* section of this publication.

There must be evidence that would enable the IRS to determine whether the use of the vehicle meets these conditions.

A control employee is an officer appointed, confirmed, or elected by the employer's boardmembers or shareholders and whose compensation is at least \$50,000, a director, any employee whose compensation is at least \$100,000, or a 1% or more equity, capital, or profits interest owner. A control employee of a government employer is any elected official or employee whose compensation is at least as much as that paid to a federal government employee at Executive Level V (for 1990 this was \$78,200). Government means any federal, state, or local

governmental unit, and their agencies or instrumentalities.

How to Report

How you report transportation (including car), travel, entertainment, and other business expenses depends on whether you are an employer, self-employed, or an employee; the type of expense (car, travel, entertainment, etc.); whether you are a qualified performing artist; the type of reimbursement or allowance arrangement involved (accountable or nonaccountable); and whether your reimbursement was more than the government rate of reimbursement.

The following discussions explain how to report your allowable car expenses. For information about reporting travel, entertainment, and gift expenses, see Publication 483, *Travel, Entertainment, and Gift Expenses*. Publication 529, *Miscellaneous Deductions*, has information about other employee business expenses.

Employers and self-employed individuals.

Employers and self-employed persons must report their travel, transportation, entertainment, and gift expenses on the appropriate form used to report their business income and expenses (such as Schedule C, Form 1040). For more information, see the instructions for the form that you file.

Employees. If you are an employee you must complete Form 2106 to deduct your expenses for travel, transportation, meals, and entertainment. If you are not deducting any of these expenses (for example, if your only expenses are for office in the home, gifts, and educational expenses not involving transportation), enter your expenses directly on line 20 of Schedule A.

Statutory employees. Statutory employees report their expenses on Schedule C instead of Form 2106. The statutory employee box on line 6 of your Form W-2 will be checked if you are a statutory employee. See Publication 529, *Miscellaneous Deductions*, for more information.

Standard mileage rate. If you claim a deduction based on the standard mileage rate instead of your actual expenses, you must complete Section B, Part II, Form 2106. The amount on line 22 (Section B) is carried to line 1, Part I, Form 2106. In addition, on line 2, Part I, Form 2106, you can deduct parking fees and tolls attributable to the business use of the car. See *Standard Mileage Rate*, earlier for information on the requirements for using this rate.

Actual expenses. If you claim a deduction based on actual expenses, you must complete Section C, Part II, Form 2106. In addition, you must complete Section D, Part II, Form 2106, to show your depreciation deduction and any section 179 deduction you can claim.

Vehicle rentals. If you claim vehicle rental expenses on line 24a, Part II, Form 2106, you may have to include in your gross income an inclusion amount (described earlier under *Leasing a Car*). If so, you can show your vehicle expenses and any inclusion amount as follows:

- 1) Compute the inclusion amount **without** taking into account your business use percentage for the tax year,
- 2) Report the inclusion amount from (1) above on line 24b, Part II, Form 2106, and
- 3) Report on line 24c the **net** amount of vehicle rental expenses (total vehicle expenses minus the inclusion amount computed in (1) above).

The net amount of vehicle rental expenses will be adjusted on line 27, Part II, of Form 2106, to reflect the percentage of business use for the tax year.

Qualified performing artist. If you are a qualified performing artist, you can deduct your performing-arts related expenses even if you do not itemize

your deductions. You must complete Form 2106, but see the special instructions for line 11. You are a qualified performing artist if:

- 1) You performed services in the performing arts as an employee for at least two employers in the tax year,
- 2) You had allowable business expenses attributable to the performing arts of more than 10% of your gross income from the performing arts, and
- 3) You had adjusted gross income of \$16,000 or less (without including expenses as a performing artist).

See Publication 529 for more information.

Unclaimed reimbursement. If you are entitled to a reimbursement from your employer but you do not claim it, you cannot claim a deduction for the expenses to which that reimbursement applies.

Reimbursements for personal expenses received from your employer must be included in your income on line 7 of Form 1040. For example, you must include in income amounts received from your employer for commuting to your regular job. These expenses are personal and you cannot deduct them.

If You Were Not Reimbursed

You are not reimbursed or given an allowance for your car expenses if you are paid a salary or commission with the understanding that you will pay your own expenses. In this situation, you have no reimbursement or allowance arrangement, and you deduct your expenses using either Form 2106 and Schedule A (Form 1040), or only Schedule A (Form 1040) if you are not required to file Form 2106. See *Employees*, earlier for information on which forms to use.

Standard mileage rate. Self-employed persons and employees can use the standard mileage rate (discussed earlier) to figure their deduction for car expenses. These taxpayers must keep records to prove the number of miles they drove and the amount of any parking fees and tolls they claim.

If You Were Reimbursed

If you received a reimbursement or allowance for your expenses, how you report this reimbursement and your expenses depends on whether the reimbursement was paid to you from an accountable or nonaccountable plan. The discussions here explain the two types of plans, simplified methods of proving the amount of your expenses, and the tax treatment of your reimbursements and expenses.

Reimbursement or allowance arrangements. A reimbursement or allowance arrangement is a system or plan that an employer uses to pay, substantiate, and recover the expenses, advances, reimbursements, and amounts charged to the employer for employee business expenses. It can also be a system used to keep track of amounts you receive from your employer's agent or a third party. Arrangements include per diem and mileage allowances. If a single payment includes both wages and an expense reimbursement, the amount of the reimbursement must be specifically identified.

Accountable Plans

To be an accountable plan, your employer's reimbursement or allowance arrangement must require you to:

- 1) Adequately account to your employer for your expenses, and
- 2) Return any excess reimbursement or allowance.

An "excess reimbursement or allowance" is any amount which you do not adequately account for as an ordinary and necessary business expense.

If your employer reimburses you under an accountable plan and you adequately account to your employer for all of your expenses within a reasonable period of time and you return any excess within a reasonable period of time, your employer should not include any of the reimbursements in your income on your Form W-2. If your expenses equal this reimbursement you can ignore both the expenses and the reimbursement when you file your return. You do not need to complete Form 2106, *Employee Business Expenses*.

If you do not return excess reimbursement. If your expenses are reimbursed under an otherwise accountable plan but you do not return, within a reasonable period of time, any reimbursement for which you did not adequately account, only the amount for which you did adequately account is considered as paid under an accountable plan. The remaining expenses are treated as having been reimbursed under a nonaccountable plan (discussed later).

Reasonable period of time. The definition of "reasonable period of time" depends on the facts of your situation. It is reasonable for you to receive an advance within 30 days of when you have an expense and to adequately account for your expenses within 60 days of when they were paid or incurred. Also, it is considered reasonable if you return any excess reimbursement within 120 days of when the expense was paid or incurred.

If you are given a periodic statement (at least quarterly) that asks you to either return or adequately account for outstanding reimbursements and you comply within 120 days of the statement, the IRS will consider the amount adequately accounted for or returned within a reasonable period of time.

Car or mileage allowances. How you report a car or mileage allowance that you received under an accountable plan depends on whether the reimbursement or your actual expenses were more than the standard mileage rate. The following discussions compare the ways that reimbursements can relate to the standard mileage rate.

Reimbursement NOT more than the standard mileage rate. Reimbursements will not be included in boxes 10 and 12 of your Form W-2 if the amount is not more than the standard mileage rate. You do not need to report the expenses or the reimbursement on your return if your expenses are equal to or less than the reimbursement. However, if your actual expenses are more than the reimbursement, you can complete Form 2106 and deduct your excess expenses on Schedule A (Form 1040). In this case you must be prepared to prove to the IRS the total amount of your expenses and reimbursements for the entire year.

Example 1. Jeremy drives 10,000 miles a year for business. As required by his employer's accountable plan, he accounts for the time (dates), place, and business purpose of each trip. His employer pays him a mileage allowance of 26 cents a mile. Jeremy's expenses of operating the car are not more than 26 cents a mile.

Jeremy's employer does not include any of the reimbursement on his Form W-2. Jeremy does not complete Form 2106 or deduct the expenses on his return.

Example 2. The facts in Matt's case are the same as those in Example 1. However, Matt's employer reimburses him for only 20 cents a mile.

Matt itemizes his deductions and decides to deduct his employee business expenses using the standard mileage rate. Since the standard mileage rate for 1990 is 26 cents a mile, Matt completes Form 2106 (showing all of his expenses and reimbursements) and enters \$600 [(10,000 miles × 26

cents a mile) - (10,000 miles × 20 cents a mile)] on line 20 of Schedule A.

Reimbursement more than the standard mileage rate. Your employer will include the reimbursement amount up to the standard mileage rate in box 17 of your Form W-2 if your reimbursement is more than the standard mileage rate. This amount is not taxable. However, the reimbursement in excess of the standard mileage rate will be included in box 10 (and in box 12 if applicable) of your Form W-2. You must report this part of your reimbursement as if it were wages.

If your expenses are not more than the standard mileage rate you do not need to complete Form 2106 or claim any of your expenses on your return. However, if your actual expenses are more than the standard mileage rate, you can complete Form 2106 and deduct your excess expenses on Schedule A (Form 1040). You must report on Form 2106 all your expenses and your reimbursements up to the standard mileage rate, and be prepared to prove these amounts to the IRS.

Example 1. Laura's employer reimburses her 30 cents a mile for each of the 10,000 business miles she drives in 1990. Her employer includes the \$400 excess over the standard mileage rate [(10,000 miles × 30 cents a mile) - (10,000 miles × 26 cents a mile)] in boxes 10 and 12 of Laura's Form W-2 as if it were wages. Her employer shows the \$2,600 (10,000 miles × 26 cents a mile) in box 17 of her Form W-2. This amount is not included in Laura's income. If Laura's expenses are not more than 26 cents a mile, she does not have to complete Form 2106.

Example 2. As in Example 1, Joe's employer paid him 30 cents a mile for each of the 10,000 business miles he drove in 1990 (10,000 × .30 = \$3,000 total). However, Joe has records showing that his actual car expenses were \$4,000. His employer's accountable plan will not pay more than 30 cents a mile, so he does not give his employer the records which prove that he actually spent \$4,000. He completes Form 2106 (showing the total for the year of all his actual expenses and his reimbursements, which were not included in his income) and enters \$1,400 (\$4,000 actual expenses - \$2,600 nontaxable reimbursement shown in box 17 of his Form W-2) on line 20 of Schedule A.

Adequate Accounting

You adequately account to your employer by giving your employer documentary evidence and an account book, diary, or similar record in which you entered each expense at or near the time you had it.

You must account for *all* amounts received from your employer during the year as advances, reimbursements, or allowances for travel, entertainment, gifts, or any other expenses. This includes amounts charged to your employer by credit card or otherwise. You must give your employer the same type of records and supporting information that you would be required to give to the IRS if it questioned a deduction on your return. You must pay back the amount of any reimbursement or other expense allowance for which you do not adequately account or that exceeds the amount for which you accounted.

Related to your employer. If you are related to your employer, you must be prepared to prove your expenses to the IRS even if you have already adequately accounted to your employer and returned any excess reimbursement. (This does not preclude your use of the standard mileage rate, discussed earlier, or a FAVR allowance, discussed later, to adequately account to your employer and the IRS.) You are related to your employer if:

- 1) Your employer is your brother or sister, half-brother or half-sister, spouse, ancestor, or lineal descendant.

- 2) Your employer is a corporation in which you own, directly or indirectly, more than 10% in value of the outstanding stock, or
- 3) Certain fiduciary relationships exist between you and your employer involving grantors, trusts, beneficiaries, etc.

You may be considered to indirectly own stock, for purposes of (2) above, if you have an interest in a corporation, partnership, estate, or trust which owns the stock or if a family member or partner owns the stock. For more details see *Related Party Transactions* in Publication 550, *Investment Income and Expenses*.

Car or mileage allowance. You may be able to prove the amount of your expense by using a car or mileage allowance amount. You have received a car or mileage allowance if your employer reimburses your expenses:

- 1) At a fixed amount per mile of business travel,
- 2) With a variable amount depending on your miles plus a flat amount based on a standard vehicle and the area, or
- 3) By any other method that is consistently applied and in accordance with reasonable business practice.

A car or mileage allowance satisfies the adequate accounting requirements for the amount if:

- 1) Your employer reasonably limits payments of the transportation expenses to those that are ordinary and necessary in the conduct of the trade or business,
- 2) The allowance is paid at the standard mileage rate, at another rate per mile, or based on a fixed and variable rate allowance (as described later), and
- 3) You prove the time, place, and business purpose of the travel to your employer within a reasonable period of time.

Proving your expenses with a car or mileage allowance. If your employer reimburses your expenses using a car or mileage allowance, you can generally use the allowance as proof for the amount of your expenses. However, the amount of expense that can be proven this way cannot be more than the standard mileage rate or the amount of the fixed and variable rate allowance (FAVR), which your employer does *not* include in box 10 of your Form W-2.

Only the amount will be considered proven under the adequate accounting requirements. You must still prove the time, place, and business purpose for each expense. The most frequently used methods of figuring a car or mileage allowance are discussed here.

Fixed mileage allowance. You are considered to have proven the amount of your expenses if your employer reimburses your car expenses at a fixed amount per business mile. However, the amount considered proven by this method cannot exceed the standard mileage rate. You must prove to your employer the date, place, and purpose for having the mileage expense.

Fixed and variable rate (FAVR). Your employer may choose to reimburse your car expenses by paying you a cents-per-mile rate to cover your operating costs (such as gas, oil, etc.) plus a flat amount to cover your fixed costs (such as depreciation, insurance, etc.). This is called a FAVR allowance. If your employer chooses to use this method your employer will request the necessary records from you and will not include any part considered to be paid from an accountable plan in box 10 of your Form W-2. The IRS will consider you to have proven the amount reimbursed by your employer (up to the amount not included in box 10 of your Form W-2).

Expenses more than car or mileage allowance. If your expenses are more than the amount considered proven because you received a car or mileage allowance, you can complete Form 2106

and deduct the excess expenses on Schedule A (Form 1040) if you itemize your deductions. You must be prepared to prove to the IRS both the amount of your expenses and your reimbursements for the entire year.

Returning Excess Reimbursements

A reimbursement or other expense allowance arrangement is not considered an accountable plan unless you are required to return any excess reimbursement to the person paying the reimbursement. "Excess reimbursement" means any amount for which you did not adequately account within a reasonable period of time. "Adequate accounting" and "reasonable period of time" were discussed earlier.

Car or mileage allowances. Your employer's reimbursement arrangement is considered an accountable plan even if you do not return the amount of an unspent car or mileage allowance to your employer as long as you prove that you did drive the number of miles for which you were reimbursed. This is because the amount (up to the amount computed under the fixed mileage allowance, fixed and variable rate allowance, or other consistent and reasonable method used by your employer) of the allowance is considered proven. Your employer will include as income on your Form W-2 the amount of your car or mileage allowance that exceeds the amount considered proven under the method your employer uses. This amount is considered paid under a nonaccountable plan.

You must prove that you actually drove the miles for which you received a car or mileage allowance. To meet the return of excess reimbursement requirements, you must return the car or mileage allowance you received for all miles that you do not prove were business miles.

Travel advance. If your employer provides you with an expense allowance, reasonably calculated not to exceed your expected expenses, before you actually have the expense, you have received a travel advance. You must adequately account to your employer for such an advance and be required to return any excess within a reasonable period of time. See *Reasonable period of time*, earlier. If you do not adequately account or do not return any excess reimbursement within a reasonable period of time, the unaccounted for or unreturned amount will be treated as having been paid under a nonaccountable plan.

Nonaccountable Plans

Any reimbursement or allowance arrangement that does not meet the requirements for an accountable plan (discussed earlier) is a nonaccountable plan. Your employer will combine the amount of any reimbursement or other expense allowance paid to you under a nonaccountable plan with your wages, salary, or other compensation and report the total in box 10 (and box 12 if applicable) of your Form W-2.

You must complete Form 2106 and itemize your deductions on Schedule A (Form 1040) to deduct your expenses for travel, transportation, meals, or entertainment. Your expenses will be subject to the 2% of adjusted gross income limit which applies to most miscellaneous itemized deductions.

Example. Kim's employer gives her \$500 a month (\$6,000 total) for her car expenses. Her employer does not require Kim to provide any proof of her expenses and Kim can keep any funds which she does not spend.

Kim is being reimbursed under a nonaccountable plan. Her employer will include the \$6,000 on Kim's Form W-2 as if it were wages. If Kim wants to deduct her business expenses she must itemize her deductions and complete Form 2106. The 2% of adjusted gross income limit applies to her total expenses.

Special rule for returning excess reimbursement. If your expenses are reimbursed under an otherwise accountable plan but you do not return,

within a reasonable period of time, any reimbursement for which you do not adequately account, only the amount for which you do not adequately account is considered as paid under a nonaccountable plan. The remainder is treated as having been paid under an accountable plan.

Completing Form 2106

The following is a brief description of how to complete Form 2106. The chart *Reporting Transportation (Car) Expenses and Reimbursements*, shown later, explains the proper reporting on Form W-2 by the employer and on Form 2106 and Schedule A by the employee. See the *Instructions for Form 2106* for additional information.

Vehicle expenses. Vehicle expenses are generally figured on Part II on Form 2106, and then claimed on line 1, Column A, of Part I of Form 2106. Claim parking fees, tolls, and local transportation expenses (including train, bus, etc.) on line 2, Column A, of Part I.

Information on cars. If you claim any deduction for the business use of a car, you must answer certain questions and provide information about the use of the car. The information relates to mileage (total, business, commuting, and other personal mileage), percentage of business use, date placed in service, use of other vehicles, after-work use, whether you have evidence to support the deduction, and whether or not the evidence is written. Employees must complete Section A, Part II, Form 2106 to provide this information. Employers, including sole proprietors, generally provide this information in Section B, Part V of Form 4562, *Depreciation and Amortization*.

Employee business expenses other than meals and entertainment. Show your other employee business expenses on lines 3 and 4, Column A. Do not include expenses for meals and entertainment in these expenses. Line 4 includes expenses such as business gifts, education (tuition and books), office in the home expense, and trade and professional publications. For information on educational expenses that you may be able to deduct, see Publication 508, *Educational Expenses*.

Meal and entertainment expenses. Show the full amount of your expenses for business-related meals and entertainment on line 5, Column B. Include meals while away from your tax home overnight and other business meals. Your meal and entertainment expenses that are subject to the 80% limit are computed in Column B of Form 2106.

Schedule A. After you have completed your Form 2106, follow the directions on that form to deduct your expenses on the appropriate line of your tax return. For most taxpayers this is on line 20 of Schedule A (Form 1040). However, certain performing artists can deduct their expenses on line 30 of Form 1040. Also, handicapped employees may be able to use line 26 of Schedule A (Form 1040).

Limitations. Your meal and entertainment expenses are subject to an 80% limitation. Most miscellaneous itemized deductions, including employee business expenses, are subject to a 2% of adjusted gross income limitation. Apply the 80% limit on your meal and entertainment expenses first (on Form 2106) and then apply the 2% of adjusted gross income limit (on Schedule A).

Allocation of reimbursement. If you receive reimbursement that is less than your employee business expenses and your expenses include meals or entertainment, you must allocate your reimbursement between the meals or entertainment expenses and the other expenses (such as car expenses). This is necessary because your deduction for meals and entertainment is limited. (See Publication 463 for more information on the 80% limit on meal and

entertainment expenses.) Use the following worksheet to allocate your reimbursement.

Worksheet

1. Enter the total amount of the reimbursements your employer gave you that were not reported to you in Box 10 of Form W-2
2. Enter the total amount of your expenses for the periods covered by this reimbursement
3. Of the amount on line 2, enter your total expense for meals and entertainment
4. Divide line 3 by line 2. Enter the result as a decimal (to at least two places)
5. Multiply line 1 by line 4. Enter the result here and in Column B, line 7
6. Subtract line 5 from line 1. Enter this result here and in Column A, line 7

Examples

The following examples and forms illustrate the reporting of car and transportation expenses on Form 2106. Other employee business expenses are not shown in these examples. Publication 463 contains examples showing the reporting of other employee business expenses.

Example 1. David Pine purchased a car for \$18,500, including sales tax, on January 5, 1990. In 1990 the car was used 70% for business purposes. A sample page from his logbook is illustrated. He records his business mileage (but not his personal miles) and expenses daily.

David completes Section A, Part II, Form 2106, as shown later on his illustrated form. He does not claim the section 179 deduction. He uses the MACRS double declining balance method to determine his depreciation deduction.

His depreciation deduction normally would be \$2,590 (\$18,500 (unadjusted basis) $\times$ 70% (business use) $\times$ 40% $\times$ 1/2 (half-year convention)). However, it is limited in the first year to \$1,862 (\$2,660 $\times$ 70%). This amount is shown in Section D, Part II.

His other car expenses included \$2,580 for gas, oil, repairs, and insurance. This amount is shown in Section C, Part II, and multiplied by the 70% business use. He adds this amount (\$1,806) to the depreciation deduction and reports the total (\$3,668) on line 1, Part I, Form 2106.

His other transportation expenses for parking fees, tolls, and taxis were \$1,190. This amount is shown on line 2, Part I.

David's employer reimbursed him a total of \$2,940 for his car and transportation expenses. This amount was paid from an accountable plan and was not shown on David's Form W-2; therefore, he shows that amount on line 7, Part I. Since David had no meal or entertainment expenses, his excess deductible expenses (\$1,918) are shown on line 11, Part I. He can deduct these expenses (subject to the 2% of adjusted gross income limit) on line 20 of Schedule A (Form 1040) if he itemizes his deductions.

Example 2. Virginia Rose purchased a car on May 25, 1989. She chose to use the standard mileage rate for 1989. She chooses to use that method for 1990. She completes Section A and Section B of Part II, Form 2106, as shown on her illustrated form. The total is carried to line 1, Part I. Her expenses for parking and tolls are shown on line 2, Part I. Her employer paid her a 20¢ per mile reimbursement during 1990. These payments were from an accountable plan and therefore were not included in her Form W-2. Virginia's deductible expenses are shown on line 11, Part I. She deducts \$1,975 (line 11, Form 2106) on line 20 of Schedule A (Form 1040). If she did not itemize her deductions, she could not deduct these expenses. These expenses are subject to the 2% of adjusted gross income limit.

Daily Business Mileage and Expense Log

Date	Destination (City, Town, or Area)	Business Purpose	Odometer Readings		Miles this trip	Expenses	
			Start	Stop		Type (Gas, oil, tolls, etc.)	Amount
4/22							
4/23	Local (St. Louis)	Sales calls	12,097	12,188	91	Gas	\$18.25
4/24	Indianapolis	Sales calls	12,211	12,486	275	Parking	\$ 2.00
4/25	Louisville	See Bob Smith ACME Corp. potential client	12,486	12,599	113	Gas/Repair Flat tire.	\$16.50 \$ 8.00
4/26	Return to St. Louis		12,599	12,875	276	Gas	\$17.25
4/27	Local (St. Louis)	Sales calls	12,914	13,005	91		
4/28							
4/22 4/28	Weekly Total		12,097		846		\$62.00
Total Year-to-Date				13,005	9,236		\$693.00

Employee Business Expenses

► See separate instructions.
► Attach to Form 1040.

OMB No. 1545-0139

1990
Attachment
Sequence No. **54**

Your name **David Pine** Social security number **559 00 9559** Occupation in which expenses were incurred **Sales**

Part I Employee Business Expenses and Reimbursements

STEP 1 Enter Your Expenses	Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
1 Vehicle expense from line 22 or line 29	1 3,668	
2 Parking fees, tolls, and local transportation, including train, bus, etc.	2 1,190	
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. Do not include meals and entertainment	3	
4 Business expenses not included on lines 1 through 3. Do not include meals and entertainment	4	
5 Meals and entertainment expenses. (See the separate Instructions.)	5	
6 Add lines 1 through 5 and enter the total expenses here	6 4,858	

Note: If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.

STEP 2 Enter Amounts Your Employer Gave You For Expenses Listed In STEP 1

7 Enter amounts your employer gave you that were not reported to you in Box 10 of Form W-2. Include any amount reported under code "L" in Box 17 of your Form W-2. (See Instructions.)	7 2,940	
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STEP 3 Figure Expenses To Deduct on Schedule A (Form 1040)

8 Subtract line 7 from line 6	8 1,918	
Note: If both columns of line 8 are zero, stop here . If column A is less than zero, report the amount as income and enter -0- on line 10, column A. See the separate Instructions for how to report.		
9 Enter 20% (.20) of line 8, Column B	9	
10 Subtract line 9 from line 8	10 1,918	
11 Add the amounts on line 10 of both columns and enter the total here. Also enter the total on Schedule A (Form 1040), line 20. (Qualified performing artists and individuals with disabilities, see the separate Instructions for special rules on where to enter the total.)	11	1,918

For Paperwork Reduction Act Notice, see the separate Instructions.

Form **2106** (1990)

Part II Vehicle Expenses (See instructions to find out which sections to complete.)**Section A.—General Information**

		(a) Vehicle 1	(b) Vehicle 2
12 Enter the date vehicle was placed in service	12	1/5/90	/ /
13 Total mileage vehicle was used during 1990	13	20,000 miles	miles
14 Miles included on line 13 that vehicle was used for business	14	14,000 miles	miles
15 Percent of business use (divide line 14 by line 13)	15	70 %	%
16 Average daily round trip commuting distance	16	10 miles	miles
17 Miles included on line 13 that vehicle was used for commuting	17	2,400 miles	miles
18 Other personal mileage (add lines 14 and 17 and subtract the total from line 13).	18	3,600 miles	miles

- 19 Do you (or your spouse) have another vehicle available for personal purposes? ☐ Yes ☒ No
- 20 If your employer provided you with a vehicle, is personal use during off duty hours permitted? ☐ Yes ☐ No ☒ Not applicable
- 21a Do you have evidence to support your deduction? ☒ Yes ☐ No. 21b If "Yes," is the evidence written? ☒ Yes ☐ No

Section B.—Standard Mileage Rate (Use this section only if you own the vehicle.)

22 Multiply line 14 by 26¢ (.26). Enter the result here and on line 1. (Rural mail carriers, see the separate instructions.)	22	
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Section C.—Actual Expenses

		(a) Vehicle 1	(b) Vehicle 2
23 Gasoline, oil, repairs, vehicle insurance, etc.	23	2,580	
24a Vehicle rentals.	24a		
b Inclusion amount	24b		
c Subtract line 24b from line 24a	24c		
25 Value of employer-provided vehicle (applies only if 100% annual lease value was included on Form W-2. See Instructions.)	25		
26 Add lines 23, 24c, and 25	26	2,580	
27 Multiply line 26 by the percentage on line 15	27	1,806	
28 Enter amount from line 38 below	28	1,862	
29 Add lines 27 and 28. Enter total here and on line 1.	29	3,668	

Section D.—Depreciation of Vehicles (Use this section only if you own the vehicle.)

		(a) Vehicle 1	(b) Vehicle 2
30 Enter cost or other basis. (See Instructions.)	30	18,500	
31 Enter amount of Section 179 deduction. (See Instructions.)	31		
32 Multiply line 30 by line 15. (See Instructions if you elected the Section 179 deduction.)	32	12,950	
33 Enter depreciation method and percentage. (See Instructions.)	33	200 DB 20%	
34 Multiply line 32 by the percentage on line 33. (See Instructions.)	34	2,590	
35 Add lines 31 and 34	35	2,590	
36 Enter the limitation amount from the table in the line 36 instructions.	36	2,660	
37 Multiply line 36 by the percentage on line 15.	37	1,862	
38 Enter the smaller of line 35 or line 37. Also enter it on line 28 above.	38	1,862	

Employee Business Expenses

► See separate instructions.

► Attach to Form 1040.

OMB No. 1545-0139

1990

Attachment
Sequence No. **54**

Your name **Virginia Rose** Social security number **303 00 1234** Occupation in which expenses were incurred **Salesperson**

Part I Employee Business Expenses and Reimbursements

STEP 1 Enter Your Expenses

	Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
1 Vehicle expense from line 22 or line 29	1 7,280	
2 Parking fees, tolls, and local transportation, including train, bus, etc.	2 295	
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. Do not include meals and entertainment	3	
4 Business expenses not included on lines 1 through 3. Do not include meals and entertainment	4	
5 Meals and entertainment expenses. (See the separate instructions.)	5	
6 Add lines 1 through 5 and enter the total expenses here	6 7,575	

Note: If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.

STEP 2 Enter Amounts Your Employer Gave You For Expenses Listed In STEP 1

7 Enter amounts your employer gave you that were not reported to you in Box 10 of Form W-2. Include any amount reported under code "L" in Box 17 of your Form W-2. (See instructions.)	7 5,600	
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STEP 3 Figure Expenses To Deduct on Schedule A (Form 1040)

8 Subtract line 7 from line 6	8 1,975	
Note: If both columns of line 8 are zero, stop here . If column A is less than zero, report the amount as income and enter -0- on line 10, column A. See the separate instructions for how to report.		
9 Enter 20% (.20) of line 8, Column B	9	
10 Subtract line 9 from line 8	10 1,975	
11 Add the amounts on line 10 of both columns and enter the total here. Also enter the total on Schedule A (Form 1040), line 20. (Qualified performing artists and individuals with disabilities, see the separate instructions for special rules on where to enter the total.)	11	1,975

For Paperwork Reduction Act Notice, see the separate instructions.

Form **2106** (1990)

Part II Vehicle Expenses (See instructions to find out which sections to complete.)**Section A.—General Information**

	(a) Vehicle 1	(b) Vehicle 2
12 Enter the date vehicle was placed in service	12 5/25/89	/ /
13 Total mileage vehicle was used during 1990	13 36,000 miles	miles
14 Miles included on line 13 that vehicle was used for business	14 28,000 miles	miles
15 Percent of business use (divide line 14 by line 13)	15 77.8 %	%
16 Average daily round trip commuting distance	16 20 miles	miles
17 Miles included on line 13 that vehicle was used for commuting	17 5,000 miles	miles
18 Other personal mileage (add lines 14 and 17 and subtract the total from line 13).	18 3,000 miles	miles
19 Do you (or your spouse) have another vehicle available for personal purposes? ☐ Yes ☒ No		
20 If your employer provided you with a vehicle, is personal use during off duty hours permitted? ☐ Yes ☐ No ☒ Not applicable		
21a Do you have evidence to support your deduction? ☒ Yes ☐ No. 21b If "Yes," is the evidence written? ☒ Yes ☐ No		

Section B.—Standard Mileage Rate (Use this section only if you own the vehicle.)

22 Multiply line 14 by 26¢ (.26). Enter the result here and on line 1. (Rural mail carriers, see the separate Instructions.)	22 7,280
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Section C.—Actual Expenses

	(a) Vehicle 1	(b) Vehicle 2
23 Gasoline, oil, repairs, vehicle insurance, etc.	23	
24a Vehicle rentals.	24a	
b Inclusion amount	24b	
c Subtract line 24b from line 24a	24c	
25 Value of employer-provided vehicle (applies only if 100% annual lease value was included on Form W-2. See Instructions.)	25	
26 Add lines 23, 24c, and 25	26	
27 Multiply line 26 by the percentage on line 15	27	
28 Enter amount from line 38 below	28	
29 Add lines 27 and 28. Enter total here and on line 1.	29	

Section D.—Depreciation of Vehicles (Use this section only if you own the vehicle.)

	(a) Vehicle 1	(b) Vehicle 2
30 Enter cost or other basis. (See Instructions.)	30	
31 Enter amount of Section 179 deduction. (See Instructions.)	31	
32 Multiply line 30 by line 15. (See Instructions if you elected the Section 179 deduction.)	32	
33 Enter depreciation method and percentage. (See Instructions.)	33	
34 Multiply line 32 by the percentage on line 33. (See Instructions.)	34	
35 Add lines 31 and 34	35	
36 Enter the limitation amount from the table in the line 36 instructions.	36	
37 Multiply line 36 by the percentage on line 15.	37	
38 Enter the smaller of line 35 or line 37. Also enter it on line 28 above.	38	

Table I

**Dollar Amounts for Years 4 — 6
Cars Leased After April 2, 1985,
And Before 1987**

Fair Market Value		Tax Year of Lease		
		4	5	6
Over	Not Over			
\$18,000	\$18,500	\$ 15	—	—
18,500	19,000	45	—	—
19,000	19,500	75	—	—
19,500	20,000	105	—	—
20,000	20,500	135	—	—
20,500	21,000	165	—	—
21,000	21,500	195	—	—
21,500	22,000	225	—	—
22,000	23,000	270	—	—
23,000	24,000	330	\$ 42	—
24,000	25,000	390	102	—
25,000	26,000	450	162	—
26,000	27,000	510	222	—
27,000	28,000	570	282	—
28,000	29,000	630	342	\$ 54
29,000	30,000	690	402	114
30,000	31,000	750	462	174
31,000	32,000	810	522	234
32,000	33,000	870	582	294
33,000	34,000	930	642	354
34,000	35,000	990	702	414
35,000	36,000	1,050	762	474
36,000	37,000	1,110	822	534
37,000	38,000	1,170	882	594
38,000	39,000	1,230	942	654
39,000	40,000	1,290	1,002	714
40,000	41,000	1,350	1,062	774
41,000	42,000	1,410	1,122	834
42,000	43,000	1,470	1,182	894
43,000	44,000	1,530	1,242	954
44,000	45,000	1,590	1,302	1,014
45,000	46,000	1,650	1,362	1,074
46,000	47,000	1,710	1,422	1,134
47,000	48,000	1,770	1,482	1,194
48,000	49,000	1,830	1,542	1,254
49,000	50,000	1,890	1,602	1,314

Table II

**Dollar Amounts for
Cars Leased After 1986 And Before 1989**

Fair Market Value		Tax Year of Lease*				
		1st	2nd	3rd	4th	5th and Later
Over	Not Over					
\$12,800	\$13,100	\$ 2	\$ 5	\$ 7	\$ 8	\$ 9
13,100	13,400	6	14	20	24	28
13,400	13,700	10	23	34	41	47
13,700	14,000	15	32	47	57	65
14,000	14,300	19	41	61	73	84
14,300	14,600	23	50	74	89	103
14,600	14,900	27	59	88	105	122
14,900	15,200	31	68	101	122	140
15,200	15,500	35	77	115	138	159
15,500	15,800	40	87	128	154	178
15,800	16,100	44	96	142	170	196
16,100	16,400	48	105	155	186	215
16,400	16,700	52	114	169	203	234
16,700	17,000	56	123	182	219	253
17,000	17,500	62	135	200	240	277
17,500	18,000	69	150	223	267	309
18,000	18,500	76	166	246	294	340
18,500	19,000	83	181	268	321	371
19,000	19,500	90	196	291	348	402
19,500	20,000	97	211	313	375	433
20,000	20,500	104	226	336	402	465
20,500	21,000	111	242	358	429	496
21,000	21,500	117	257	381	456	527
21,500	22,000	124	272	403	483	558
22,000	23,000	135	295	437	524	605
23,000	24,000	149	325	482	578	667
24,000	25,000	163	356	527	632	729
25,000	26,000	177	386	572	686	792
26,000	27,000	190	416	617	740	854
27,000	28,000	204	447	662	794	917
28,000	29,000	218	477	707	848	979
29,000	30,000	232	507	752	902	1,041
30,000	31,000	246	538	797	956	1,104
31,000	32,000	260	568	842	1,010	1,166
32,000	33,000	274	599	887	1,064	1,228
33,000	34,000	288	629	933	1,118	1,291
34,000	35,000	302	659	978	1,172	1,353
35,000	36,000	316	690	1,023	1,226	1,415
36,000	37,000	329	720	1,068	1,280	1,478
37,000	38,000	343	751	1,113	1,334	1,540
38,000	39,000	357	781	1,158	1,388	1,602
39,000	40,000	371	811	1,203	1,442	1,665
40,000	41,000	385	842	1,248	1,496	1,727
41,000	42,000	399	872	1,293	1,550	1,789
42,000	43,000	413	902	1,338	1,604	1,852
43,000	44,000	427	933	1,383	1,658	1,914
44,000	45,000	441	963	1,428	1,712	1,976
45,000	46,000	455	994	1,473	1,766	2,039
46,000	47,000	468	1,024	1,518	1,820	2,101
47,000	48,000	482	1,054	1,563	1,874	2,164
48,000	49,000	496	1,085	1,608	1,928	2,226
49,000	50,000	510	1,115	1,653	1,982	2,288
50,000	51,000	524	1,146	1,698	2,036	2,351
51,000	52,000	538	1,176	1,743	2,090	2,413
52,000	53,000	552	1,206	1,788	2,144	2,475
53,000	54,000	566	1,237	1,834	2,198	2,538
54,000	55,000	580	1,267	1,879	2,252	2,600
55,000	56,000	594	1,297	1,924	2,306	2,662
56,000	57,000	607	1,328	1,969	2,360	2,725
57,000	58,000	621	1,358	2,014	2,414	2,787
58,000	59,000	635	1,389	2,059	2,468	2,849
59,000	60,000	649	1,419	2,104	2,522	2,912
60,000	62,000	670	1,465	2,171	2,603	3,005
62,000	64,000	696	1,525	2,262	2,711	3,130
64,000	66,000	726	1,586	2,352	2,819	3,255
66,000	68,000	753	1,647	2,442	2,927	3,379
68,000	70,000	781	1,708	2,532	3,035	3,504
70,000	72,000	809	1,768	2,622	3,143	3,629
72,000	74,000	837	1,829	2,712	3,251	3,753
74,000	76,000	865	1,890	2,802	3,359	3,878
76,000	78,000	892	1,951	2,892	3,468	4,003
78,000	80,000	920	2,012	2,982	3,576	4,128
80,000	85,000	969	2,118	3,140	3,765	4,346
85,000	90,000	1,038	2,270	3,365	4,035	4,658
90,000	95,000	1,108	2,422	3,590	4,305	4,969
95,000	100,000	1,177	2,574	3,816	4,575	5,281

*For the last tax year of the lease, use the dollar amount for the preceding year.

Table III

**Dollar Amounts for Cars
First Leased in 1989 or 1990**

Fair Market Value		Tax Year of Lease*				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
\$ 12,000	\$ 13,100	\$ 0	\$ 0	\$ 0	\$ 1	\$ 2
13,100	13,400	0	2	3	5	9
13,400	13,700	3	11	15	21	26
13,700	14,000	8	19	29	37	45
14,000	14,300	12	29	42	53	64
14,300	14,600	16	38	55	70	83
14,600	14,900	20	47	69	86	101
14,900	15,200	24	56	83	102	120
15,200	15,500	28	65	97	118	139
15,500	15,800	33	74	110	134	158
15,800	16,100	37	83	123	151	176
16,100	16,400	41	93	136	167	195
16,400	16,700	45	102	150	183	213
16,700	17,000	49	111	164	199	232
17,000	17,500	55	123	182	220	258
17,500	18,000	62	138	204	248	289
18,000	18,500	69	153	227	275	319
18,500	19,000	76	168	250	301	351
19,000	19,500	83	184	271	329	382
19,500	20,000	90	199	294	356	413
20,000	20,500	97	214	317	382	445
20,500	21,000	104	229	339	410	476
21,000	21,500	111	244	362	437	507
21,500	22,000	117	260	384	464	538
22,000	23,000	128	282	419	504	585
23,000	24,000	142	313	463	558	647
24,000	25,000	156	343	508	613	709
25,000	26,000	170	373	554	666	772
26,000	27,000	183	404	599	720	834
27,000	28,000	197	435	643	774	897
28,000	29,000	211	465	688	829	959
29,000	30,000	225	495	734	882	1,021
30,000	31,000	239	526	778	936	1,084
31,000	32,000	253	556	824	990	1,146
32,000	33,000	267	586	869	1,044	1,209
33,000	34,000	281	617	913	1,099	1,270
34,000	35,000	295	647	959	1,152	1,333
35,000	36,000	309	677	1,004	1,206	1,396
36,000	37,000	322	708	1,048	1,260	1,458
37,000	38,000	336	738	1,094	1,315	1,520
38,000	39,000	350	769	1,139	1,368	1,583
39,000	40,000	364	799	1,184	1,423	1,644
40,000	41,000	378	829	1,230	1,476	1,707
41,000	42,000	392	860	1,274	1,530	1,770
42,000	43,000	406	890	1,319	1,585	1,832
43,000	44,000	420	920	1,365	1,638	1,894
44,000	45,000	434	951	1,409	1,693	1,956
45,000	46,000	448	981	1,454	1,747	2,019
46,000	47,000	461	1,012	1,499	1,801	2,081
47,000	48,000	475	1,042	1,545	1,854	2,144
48,000	49,000	489	1,073	1,589	1,909	2,205
49,000	50,000	503	1,103	1,634	1,963	2,266
50,000	51,000	517	1,133	1,680	2,016	2,331
51,000	52,000	531	1,164	1,724	2,071	2,393
52,000	53,000	545	1,194	1,770	2,124	2,455
53,000	54,000	559	1,224	1,815	2,179	2,517
54,000	55,000	573	1,255	1,859	2,233	2,580
55,000	56,000	587	1,285	1,905	2,286	2,643
56,000	57,000	600	1,316	1,950	2,340	2,705
57,000	58,000	614	1,346	1,995	2,395	2,767
58,000	59,000	628	1,376	2,041	2,448	2,829
59,000	60,000	642	1,407	2,085	2,502	2,892
60,000	62,000	663	1,452	2,153	2,584	2,985
62,000	64,000	691	1,513	2,243	2,691	3,110
64,000	66,000	719	1,574	2,332	2,800	3,235
66,000	68,000	746	1,635	2,423	2,907	3,360
68,000	70,000	774	1,695	2,514	3,015	3,484
70,000	72,000	802	1,756	2,603	3,124	3,609
72,000	74,000	830	1,817	2,693	3,232	3,733
74,000	76,000	858	1,877	2,784	3,340	3,858
76,000	78,000	885	1,939	2,873	3,448	3,983
78,000	80,000	913	1,999	2,964	3,556	4,107
80,000	85,000	962	2,106	3,121	3,745	4,325
85,000	90,000	1,031	2,258	3,346	4,015	4,638
90,000	95,000	1,101	2,409	3,572	4,285	4,949
95,000	100,000	1,170	2,562	3,796	4,556	5,261

*For the last tax year of the lease, use the dollar amount for the preceding year.

Reporting Transportation (Car) Expenses and Reimbursements

Type of Reimbursement or Other Expense Allowance Arrangement	Employer Reports on Form W-2	Employee Shows on Form 2106	Employee Claims on Schedule A
Accountable Adequate accounting and excess returned	Not reported	Not shown	Not claimed
Adequate accounting and return of excess both required but excess not returned	Excess reported as wages in Box 10 and, if applicable, in Box 12. Amount adequately accounted for is reported only in Box 17—it is <i>not</i> reported in Box 10 or in Box 12.	All expenses, and reim- bursements reported on Form W-2, Box 17, <i>only</i> if some or all of the unre- turned excess expenses are claimed. ¹ Otherwise, form is not filed.	Expenses the employee can prove and which exceed the reimburse- ments received and reported on Form W-2, Box 17. ²
Mileage allowance (up to standard mileage rate) Adequate accounting and excess returned	Not reported	All expenses and reim- bursements <i>only</i> if excess expenses are claimed. ¹ Otherwise, form is not filed.	Expenses the employee can prove and which exceed the reimburse- ments received. ²
Mileage allowance (exceeds standard mileage rate) Adequate accounting up to the standard mileage rate only and excess not returned	Excess reported as wages in Box 10 and, if applicable, in Box 12. Amount up to the stan- dard mileage rate is reported only in Box 17—it is <i>not</i> reported in Box 10 or in Box 12.	All expenses, and reim- bursements equal to the standard mileage rate, <i>only</i> if expenses in excess of the standard mileage rate are claimed. ¹ Otherwise, form is not filed.	Expenses the employee can prove and which exceed the standard mileage rate. ²
Nonaccountable Either adequate accounting or return of excess, or both, not required	Entire amount is reported as wages in Box 10 and, if applicable, in Box 12.	All expenses ¹	Expenses the employee can prove. ²
No reimbursement	Normal reporting of wages, etc.	All expenses ¹	Expenses the employee can prove. ²

¹ Any allowable expense is carried to line 20 of Schedule A and deducted as a miscellaneous itemized deduction.

² These amounts are subject to the 2% of adjusted gross income limit on miscellaneous itemized deductions.

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